Canada. Parliament. Senate.
Stdg. Cttee. on Banking, trade
and commerce.
Proceedings. 1969-70. no. 17-23.

679m

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

Nº 17-23

THURSDAY, APRIL 16th, 1970

Eleventh Proceedings on the Government White Paper,

entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 17:5)

APPENDICES:

"A"—Brief from The Law Society of Upper Canada.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from The Bar of the Province of Quebec.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from the Retail Council of Canada.
"F"—Analysis of Appendix "E" by Senior Advisor.
"G"—Brief from McLaughlin, May, Soward, Morden & Bales; Barristers.
"H"—Analysis of Appendix "G" by Senior Advisor.
"I"—Salient points of brief from John Labatt Limited.

21847-1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and record upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21847—1½

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 16, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (Rigaud), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Haydon:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

Thursday, April 16th, 1970
(23)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Cook, Blois, Burchill, Carter, Connolly (*Ottawa West*), Desruisseaux, Flynn, Everett, Haig, Isnor, Lang, Leonard, Molson, Phillips (*Rigaud*) and Welch—(17).

Present, but not of the Committee: The Honourable Senators Aird, Laird and Smith—(3).

In attendance: Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Retail Council of Canada

Mr. A. J. McKichan, General Manager—Retail Council.
Mr. D. E. Knechtel, Tax and Insurance Manager, T. Eaton Company.
Mr. W. M. Moffat, Comptroller—S. S. Kresge Co.
Mr. G. E. Hall, General Accounting Manager, Robert Simpson Co.
Mr. G. W. Brown, Managing Director—C. J. Eames & Co.
Mr. P. Kemerer, Assistant Comptroller—Loblaw Groceteria Co. Ltd.
Mr. G. E. Conkwright, Partner, Clarkson, Gordon & Co.

The Law Society of Upper Canada

Mr. S. Thom, Q. C.
Mr. W. G. C. Howland, Q. C.

Bar of the Province of Quebec

Mr. C. Gagnon, Batonnier of the Province of Quebec.
Mr. P. Vineberg, Q. C., Batonnier of Montreal.

Ordered,—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from The Law Society of Upper Canada.
B—Analysis of Appendix "A" by Senior Advisor.
C—Brief from The Bar of the Province of Quebec.
D—Analysis of Appendix "C" by Senior Advisor.
E—Brief from the Retail Council of Canada.
F—Analysis of Appendix "E" by Senior Advisor.
G—Brief from McLaughlin, May, Soward, Morden & Bales, Barristers.

H—Analysis of Appendix "G" by Senior Advisor.
I—Salient points of brief from John Labatt Limited.

At 12:30 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, April 16, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: The first submission this morning will be from the Law Society of Upper Canada. We have here Mr. Thom and Mr. Howland. Have you a summary you would like to present first?

Mr. W. G. C. Howland, Q.C., the Law Society of Upper Canada: Yes, I have, Mr. Chairman.

The Chairman: The floor is yours. You can sit down and do your job or stand up, whichever you like.

Mr. Howland: Mr. Chairman, honourable senators, I would like first to deal with one or two introductory matters, and then there are two points in particular that I would like to cover. Then I will ask Mr. Stuart Thom, who is the Chairman of our Special Committee on the White Paper and is a recognized specialist in the tax field, to deal more specifically with some of the tax problems.

The Law Society of Upper Canada, of which I am the head, is the governing body of the legal profession of Ontario. It has approximately 7,400 members, of which there are some 5,800 in practice. These numbers are slightly larger than those before you in your summary, because we have called an additional class of 444 to the bar since the brief was filed.

There are over 17,000 members of the legal profession in Canada, and the conference of the governing bodies of the legal profession, in which all of the governing bodies are officially represented, met in Winnipeg on April 4 and 5 last, and Mr. Gagnon, the batonnier of the Quebec Bar, and I were asked to convey to the committee the following resolution, which was unanimously passed at that meeting:

> The Conference of governing bodies of the legal profession in Canada is opposed to the proposal contained in the White Paper on Tax Reform, that professional persons be required to report their income on an accrual basis rather than on a cash basis, both as it relates to unbilled time and to unpaid accounts.

The brief of the Law Society of Upper Canada is confined to the one proposal, that professional persons should be required to report their income on an accrual basis rather than on a cash basis, and that they should be required to bring into income their inventory of unbilled time. The Canadian Bar Association will be dealing with a number of other matters respecting the White Paper, but the Law Society has confined its brief to this one point because it is the one which is of vital importance to the profession.

The Treasurer of the Law Society of British Columbia, who I might explain is the head of that society, has also asked Mr. Thom and I to speak to their brief, which has been filed and is confined to the same proposal.

Very shortly after the appearance of the White Paper, the Law Society of Upper Canada invited submissions from its members, and a great many letters were received from all parts of the province, from both large and small law firms, from individual practitioners, and from law associations, expressing their strong opposition to the proposals.

I will not myself deal with the question of the fairness of the proposals to the legal profession, or the fact that the cash basis is the recognized basis in other leading countries for the legal profession. I am leaving those matters to Mr. Stuart Thom to deal with, and also the portion of the proposal as to unbilled time, which it is respectfully submitted is completely unworkable.

There are two aspects in particular that concern the Law Society so far as the public interest is concerned. One of the fundamental aspects of a profession is the fact that it involves a duty to serve the public. This is the aspect which all of the professions are very conscious about and it is one aspect which differentiates professions from business generally. A lawyer's first consideration must be the needs of his own client and not to his client's ability to pay. We have constantly stressed in the training of future lawyers that their approach to the practice of law must not be an approach to commercialism. A lawyer is not permitted, for example, to advertise or solicit business. On a cash basis the lawyer is able to assess

the time and the ability of his client to pay. If the accrual basis on the other hand is adopted it will force the lawyer to put pressure on his clients to pay the accounts and could have a very adverse effect on the relationship between a solicitor and his client. In other words, to put it very briefly it is going to put a premium on what are the most effective collection methods.

This matter is of very considerable concern to the legal profession because there is a very real danger that this type of approach will completely undermine what is the very essence of the profession. We should be thinking primarily of the social needs and the needs of the client itself. We should not have the members of our legal profession sitting down and first of all considering the question as to whether a client can pay or not. This should never become the prime consideration as far as the lawyer is concerned.

The second aspect I would like to deal with is a question which is also very worrisome as far as the legal profession is concerned and that is the serious effect this proposal will have on the younger members of the profession. Our profession at the present time is growing extremely rapidly. We have about 7,400 members and within the next five years that number is going to increase by over one-third to something over 10,000.

Most lawyers are entering the practice after some 7½ years of higher education. In this way they are rendering the profession with a very substantial personal debt as far as they are concerned as a result of having to finance their higher education. Many smaller communities are served by these lawyers who practice by themselves and it is important that these communities should continue to be served in this way. There are, of course, in the larger centres also a considerable number of individual practitioners. They form a very substantial portion of the entire profession. The lawyers' rent and the secretarial staff, which can readily be appreciated, must be paid in cash. The accrual system would not only be very costly to a young lawyer in time, because of having to adopt more sophisticated bookkeeping systems, but it would force him to pay tax on moneys which he has not received. Here is the main nub of the problem. Unless he had substantial financial resources he would not be able to do that. We think that the net effect would be, from the public point of view, that the smaller and the more remote communities of the province, such as in places like Kenora and Fort Frances would probably suffer because they would lose the services of the sole practitioners who would have to gravitate, as a result, to the firms in the larger centres who are able to provide these services and carry on in that particular way.

Those were the two points which I mainly wanted to emphasize because I think they have a very serious public aspect as far as the profession is concerned. With your permission I would now like Mr. Stuart Thom to deal with the other matters in our brief.

Mr. S. Thom, Q.C. Member, The Law Society of Upper Canada: Thank you honourable senators. It was good of the Chairman to suggest that the Law Society in Canada might open the proceedings. The literary qualities of the brief prepared by our friends of Quebec are so much greater than ours that possibly they should have been here first. We will take the opportunity which has been offered.

The treasurer has touched on the very important point of our submission. I have, myself, been dealing with rather more technical matters. First of all, I draw your attention to Mr. Gilmour's very helpful comments which brought out very well indeed certain highlights of our submission. It gives you the opportunity of having before you the present tax laws, the tax reform proposals and the principal points of the brief.

It is not exactly accurate to say that we represent unanimous opinion of the Bar of Ontario. There are some large corporate type firms that have been in existence for many years who could adapt themselves to what is known as the accrual method of accounting, but they are very much in minority. We can say in complete accuracy that the very very substantial feeling of the Bar of Ontario is one of great concern of the White Paper proposal. The submissions that we received in response to our request for comments from the Bar have all been very strong in their opposition to the suggestions that are being made in the paper. The unanimity is of a very substantial degree.

The White Paper, as is pointed out in the comments of your adviser, takes the position that generally taxpayers in business must compute their taxable income on what is known as the accrual basis. With respect to the draftsman of the paper we take exception to this. We also might point out, although by definition in the statute, the profession of law is treated as a business, as our treasurer has already indicated to you. We do not regard ourselves as being in business in a manner in the way comparable to those of trade and commerce. No invidious distinctions are intended, but I will mention in a moment certain very definite distinctions. As honourable senators know a method of a so-called cash method for determining income in a business was the accepted and approved way up until 1948. The present endorsement of the Exchequer Court in 1946 laid down the law. It was then in their minds, namely, that the accrual method was not satisfactory and the Income Tax Act of 1948 and 1949 opened the door to the imposition or the application of the accrual method to ordinary business. It was not until 1954 or 1955 that the statutes were amended to specifically include the statement that farmers and the professions might report on the cash basis. They make the point that this

statutory amendment was not to extend the concession to the professions or to farming, but by indicating that they had the right to file on the cash basis and that administration was able to exclude all other businesses from the use of the cash basis.

This was a section of the act which was intended to lay down rules for business at large and in the course of so doing, by including certain taxpayers in the cash basis method, others were excluded. That was the intent of the amendment in 1955 and it was not at that time a concession granted to professions.

Senator Everett: Prior to 1955 is it correct that a business could choose the cash or the accrual method?

Mr. Thom: For some years before that, senator, there had been a series of cases brought before the tribunals by the tax department, attempting and successfully imposing on business—I use it in the commercial sense—the obligation to report on the accrual method. The 1955 amendment tended to clarify the law. It also had the effect of preventing businesses that were selling out from avoiding the tax on the inventory which they then sold in bulk. The tax department, even before 1955 had been imposing upon business in the commercial sense the obligation to report on the accrual method.

Senator Connolly (Ottawa West): The rationale behind the legislation of 1955 of course is not binding, but do you remember what the rationale was in respect of the effect upon the legal profession at that time? Did they say that you had, because of the profession, the character of a professional man, whether a lawyer, doctor, engineer or accountant? Did they say it was pretty well what you described to us this morning?

Mr. Thom: I do not know, senator. At that time we felt is was included in a section of the act but did not apply to us as lawyers in regard to income. We had always been outside the concept of income. This was a section of the act directed to the reporting of income by a business and it did not have an impact on us as earnings in the profession.

Senator Connolly (Ottawa West): In 1955, it was made explicit.

Mr. Thom: The Treasurer has dealt with the distinction which we feel is a very valid and vital one, between our activities, our occupation, and that of business. In our brief, on page 3, we have drawn attention to a number of those differences, the fact that we cannot advertise, that we cannot solicit business, that communications between the lawyer and his client are privileged against inquiry from any authority, that the practice of law cannot be carried on through or by a corporation and as a consequence the lawyer is unable to enjoy the special advantages of incorporation; and other such matters. This leads to the point that we do not consider that we have anything that could be called an inventory of unbilled time—and this concept is basic to the proposal in the White Paper.

With all respect to the draftsman of the White Paper, we take very basic and strong exception to the concept of an inventory of unbilled time.

We have unpaid accounts, and we have work which we are doing which had not been billed. But, for reasons which we have attempted to develop in our brief and which are further well developed indeed in the brief which will be submitted to you by the Bar of Quebec, we take strong exception to the concept of our inventory of work not yet paid for—if I may use it that way—as being an inventory comparable to goods on the merchants shelf.

Senator Molson: I should like to ask Mr. Thom, what about retainers. They would, in a sense, be an inventory.

Mr. Thom: At this point, Senator Molson, I perhaps may be allowed to digress slightly. If the retainer is received for work which you may do, or to hold your attention to the client, it comes into your income as cash when received. In Canada, it is put into a trust account, under recent rules and regulations of the Tax Department, to be drawn upon when you have done the work that you have been asked to do. Until such time, it is not income in your hands, as long as it is in the trust account. This is in a recent bulletin of information published by the Tax Department last fall.

The Chairman: Would you call it a payment on account in advance?

Mr. Thom: This payment in advance may or may not be regarded as income in cash, depending on whether or not you have the right to use it.

Senator Molson: There will be a number of differences in types of retainers, surely? There could not be one general kind.

Mr. Thom: Yes, indeed. The word "retainer" is a difficult word to use, because it has no exact meaning.

Senator Molson: It could be, perhaps, that 11 months of a period would have gone by, in which it was known that a fee would be paid and which had not been yet received, and I suppose, as distinct from the work done for clients in individual cases, it could be regarded rather differently?

Mr. Thom: Yes.

Senator Phillips (Rigaud): This question which I want to put to Mr. Thom is in regard to the accrual basis, the assimilation of the value of inventory in relation to the value of inventory on hand. The word "inventory" in the statute clearly is intended to put a value on the basis of cost or market value, whichever is the lower. If such professional work is similar to inventory, the assumption is that the lawyers or other professional men could go out on the market and would be entitled to sell their inventory at cost or market value, whichever was the lower. I only mention that to show the absurdity of assimilating.

Mr. Thom: Indeed, I can only express my concurrence with your rhetorical question, by saying that that is the substance of our submission to the committee.

Senator Connolly (Ottawa West): Or have a January "white sale".

The Chairman: Would you care to comment on the use of the words "tax postponement" in paragraph 5.46? I have the greatest difficulty in trying to interpret it. They seem to describe unbilled time, that this creates a tax postponement.

Mr. Thom: In our efforts to comprehend the White Paper and understand it . . .

Senator Phillips (Rigaud): May I interrupt by suggesting that we sympathize with you in your effort to understand it.

The Chairman: That is what we are trying to do.

Mr. Thom: The tax department takes it as though in each hour of the day we work X hours and earn X dollars and somehow or other you record the fact that you worked those hours and you put this sum you earned into the bank.

Senator Connolly (Ottawa West): Which is not so.

Mr. Thom: This is basically not so.

Senator Connolly (Ottawa West): Not in a profession.

Mr. Thom: We can only suggest that those who drafted the document had their minds turned to business as a commercial business and in this respect failed to really understand how the profession, the law profession, is run.

Senator Everett: Dealing with a commercial business for a moment and comparing it, I think probably there is an area here that cannot be compared, but because of the similarity between the two areas, I would like you to show us the difference, because if there is a difference it must exist.

In the service business, where you are selling services to the public, and the department requires you, at the end of the year, to accrue a working process account, and that working process account is taken into income and the appropriate costs that are attributable to the work that has been done, are deducted, and the difference is added to your profit. A television repairman, for example, would take his work in process into account in any taxation year. I suspect that there is a difference between his problem or that of anyone in the commercial service, and the problem in the legal profession in doing the same thing. I wonder if you could comment on that difference.

Mr. Thom: I would be happy to try, Senator Everett. We feel that the difference is that a TV serviceman has entered into a contract with the customer to render service, at whatever rate is proposed, perhaps not a published rate but a fairly established rate, and the contract arises whereby he is entitled to get paid on a fixed time basis. That includes the cost of his getting to the house and back, and all the rest of it, or taking the machine to the shop. This contract builds up on a definite dollar per hour basis. Under the act that is assimilated to accumulation of earnings.

The legal profession does not earn income on that basis. Our accounts are strictly speaking a memorandum to our clients, saying we feel thay should pay this amount for the services we have given. If a client chooses not to accept our memorandum of what we feel he should pay, he can have it taxed. We have no contract and no right to demand the fee.

Senator Everett: To follow that through. Your argument seems to be valid in my mind. It is that you cannot determine, if you are asked to create a working process account, you cannot determine with any accuracy at that particular time what the value of the working process is.

Mr. Thom: I would not feel it is right to give you a categorical "no" to your question, but in the great majority of instances the answer is that we could not determine.

The matter is mentioned on page 6, in which we review various types of legal practices, and in many instances that we attempt to show in the five categories listed on pages 6 and 7, the lawyer does not know at the time he is working, what his fee will be, and he cannot know, he cannot tell what time he is going to be required to spend, and what fee the client might be prepared to pay, or what the outcome of the case will be. There is a great variety of items that enter into it.

Senator Laird: Results count.

Mr. Thom: Yes. Therefore, we don't earn on an hourly dollars basis. This is the substantial difference between ourselves and the service industries.

Senator Connolly (Ottawa West): You mentioned the position of the lawyer practising alone and in a smaller sense. First of all, he is subject to any charges for litigation he makes being subject to be taxed by the court official. In a great many of these cases, too, people see that lawyer and confide in him more than they would in any other person, particularly in respect of their estates. And the people who survive make him their executor and expect him to look after their affairs when they pass on. It seems to me that apart from the legal fees these men charge their legal work, they also have executors' fees which they become entitled to on a certain scale. But in each of those cases they cannot be sure until the surrogate judge has passed the accounts and set out how much they are entitled to for the legal fees as he surveys the record, the diary and the statement of the kind of work done, and as he surveys, too, the kind of responsibility that was taken by the lawyer in question as an executor. So that, to be even more precise, I am disregarding for the moment the fact that if he values the money on an accrual basis at a certain figure and that is cut down, he might not be able to claim a loss at a subsequent time.

Mr. Thom: It would be quite impossible for him to do that.

Senator Connolly (Ottawa West): That is right.

Mr. Thom: Yes.

Senator Connolly (Ottawa West): So the result is that he may be paying tax on money he will never get.

Mr. Thom: It could very well be, and that is the case that will face him if the White Paper proposals go through.

Senator Connolly (Ottawa West): I am particularly concerned there about the position of the lawyer practising alone who is rendering a rather special kind of personal service to people who in the nature of the case depend upon him.

Mr. Thom: Many hours of his time are spent talking to people—I hesitate to use the word "comforting", but it may be appropriate—and comforting them and holding their hands, for which no charge can be made. And then the occasion may arise in which his skill, wit and experience bring about a business result which is extremely satisfactory to them and they say, "I hope you will reward yourself adequately, because we are very satisfied." So the humps and hollows of the legal income of the single, small practitioner are very severe. To say he earns on an average daily hourly basis is so remote from the facts that, as I say, our profession is terribly disturbed at the suggestion that they should have to bring into income daily basis amounts they have not received and have no legal claim to.

The Chairman: Mr. Thom, it seems to me that the concept of inventory, the general concept, is something that is physical, and the price is regulated by the person who produces it; that is the price and there is nobody sitting above him to tell him he has to change his price and reduce it.

Mr. Thom: In this modern world?

The Chairman: Subject only to the efforts being made recently, which may not be very successful.

Mr. Thom: I agree with the distinction you make.

The Chairman: You agree with the distinction?

Mr. Thom: Indeed.

The Chairman: When a lawyer puts in a time charge, that is simply recording the actual time that is spent on that work. He has nothing in the way of billing at that time.

Mr. Thom: No, nothing.

The Chairman: And even when he finally bills the client, the client can go to the taxing officer, or the lawyer may have to go to the taxing officer if he wants to make efforts to collect the account.

Mr. Thom: Indeed.

The Chairman: So how can it be described that there is a tax postponement, when you put a time charge in your books because you are on a cash basis? A tax postponement means that there is some liability for tax or that you are subject to tax that is deferred. How can a time charge be subject to that?

Mr. Thom: I am afraid we don't understand it any better than you do, Mr. Chairman.

The Chairman: I am looking for help.

Mr. Thom: I have no answer to give you on that point that would satisfy me as a good answer.

The Chairman: Notice the language. They use the words "tax postponement" and the words "an unwarranted advantage". What does that mean? Whoever wrote that didn't know what he was talking about.

Mr. Thom: If I may say so, he was writing it from the viewpoint that law was just another business. But in business, as Senator Everett pointed out, if you sell goods that are not yet paid for at the end of the tax period, the custom is by law and statute that you bring into your income for that year the receivable that resulted from your business transactions because you expect to collect it in a certain fixed amount, and if you don't pay that tax in the year the sale was made, it can be said that there is a postponement of the tax that is paid until the year the fixed amount is collected. This is legitimate in business. But our point is that we may keep a memorandum of the time we spend and we may know for whom we were doing work, but how much we earned at that time—to analogize it to receivable is simply foreign to the whole concept of the way we do our business.

Senator Hays: In a large firm you would have paid some of it, if you had given the work to a junior lawyer and had had to pay him. For this particular part of the exercise you would have paid for these services, wouldn't you?

Mr. Thom: The large firm with a staff of various sorts and junior lawyers has its ongoing expenses to meet, of course, which it covers from the collections from business done in the past, apart from any capital that the partners put into the firm.

Senator Hays: But maybe the junior lawyer gets $15 and there is a difference between that $15 and the $60 you charge. Is that not part of the fee that you are speaking of?

Mr. Thom: I don't recognize that as part of the fee that the White Paper draftsman is thinking of.

Senator Hays: It is like me pricing a bull on my ranch. The foreman phones me up and says he has a bull to sell to a guy who wants it and what should he price it at, and I say, "I can't tell 'til I see the fellow."

Mr. Thom: That analogy is not in our brief, senator.

Senator Connolly (Ottawa West): Mr. Thom, I don't knock business. Business is the lifeblood of the country. But in the province of Quebec and in the civil law systems, generally, they give a name to a lawyer; they call him "Maître". There is no such thing in the common law provinces or the common law countries. But the idea is there, I think, that the professional man is in a different class. The architect cannot call himself anything. The dentist calls himself doctor; the medical man calls himself doctor; the engineer doesn't call himself anything; but in the legal profession, at least on the civil side, there is that notion of "Maître" which means more than simply a man interested in making money. It emphasizes the professional aspect of the work, and while it has a commercial side, too, or it could not be done, nonetheless, I think that professional character is emphasized there and I think it is the kind of thing in the common law provinces that we think more and more about as we become more sophisticated.

Mr. Thom: Senator, I completely agree, and the Treasurer in his opening remarks attempted to show, and I hope did show, that this is the constant concern of the Society, to ensure that the professional quality of our activities is constantly kept in focus and that we don't just become a money-making operation.

Senator Molson: Mr. Chairman, I take it that among the uncertainties is the question as to what the billings might be in the case of any contingencies. Is it on a contingency basis?

The Chairman: No, it is not permitted.

Mr. Thom: That is so, senator, although there are occasions when the outcome of the work you do justifies some recognition of your success.

Senator Molson: A grateful client?

Mr. Thom: A grateful client.

The Chairman: What you mean is you feel you are entitled to charge a plus?

Mr. Thom: And the client is happy to pay.

Senator Desruisseaux: May I ask Mr. Thom about something that appears in paragraph 5.46 of the White Paper proposals. It says in the paragraph:

> The government believes that the tax postponement permitted by this concession has given professionals and unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.

What is your reaction to that? Do you believe this to be the situation?

Mr. Thom: I cannot agree with the concept that we have an unwarranted advantage. I would point out here, senator, that the submission being made to you at the moment is on behalf of the legal profession, and this is a general comment being made here with regard to something described as professions.

Senator Desruisseaux: Yes, I noticed that—as applied to professions—but how does it apply to the legal profession?

Mr. Thom: God forbid that we should be thought to be putting ourselves on some special platform, but I do feel that we have some special consideration

because our activities are different and have special qualities. This is not a brief on behalf of the professions generally but on behalf of the legal profession. Now with regard to ourselves, for the reasons that we are developing this morning, we feel that this concept of postponement is not correct. Whether other professionals within the concept of the meaning of this clause would go along with this, I am not prepared to say.

Senator Connolly (Ottawa West): The dentists agreed with you when they were here yesterday.

Mr. Thom: To say that we are postponing tax because we are not paying tax on some amount which we eventually hope to receive, which is our position, we feel to be a misconception.

Senator Everett: Referring to accounts, Mr. Thom, the fact that if you went on an accrual basis, you would also be permitted by virtue of that to set up a reserve against bad debts which you obviously don't set up now being on a cash basis . . .

Mr. Thom: No, we don't.

The Chairman: Senator Everett, at that stage if you were on an accrual basis and you were billing time or you were bringing unbilled time into inventory, how could you create a reserve against that if you have not even billed it?

Senator Everett: There are two aspects to this problem. One is the fact that you would have accounts receivable, that is billed time that had not been collected.

The Chairman: That differs, of course, from unbilled time.

Senator Everett: As I say, there are two aspects to this, one is the billed time which is not collected and which you would be required to take into income and against which you could set up a reserve for bad debts. The other aspect, of course, is work in process which you would be required to take into income, and of course you could not set up a reserve against that because you would not have billed it and you would not know whether in fact it was a bad debt. Now I am just wondering about this. What the department or what the government is concerned about here is nothing more than a deferral of tax. This is not a tax saving.

Mr. Thom: There is no tax saving involved anywhere here.

Senator Everett: Because the lawyer pays his full tax on a cash basis.

Mr. Thom: Yes.

Senator Everett: So what the department is talking about is a deferral of tax.

Senator Molson: An acceleration of tax.

Senator Everett: But taking into account that on the receivable portion you could set up a reserve against bad debts, how much are they talking about in terms of income to government which can be nothing more than the interest on the difference between the two pieces of money over a period of six months or five months or at most a year. It is rather an insignificant amount they are concerning themselves about.

Mr. Thom: The legal profession is by no means the largest of the income earning operations in Canada and the amount billed in unpaid legal accounts at the end of the year is not, in my view, a substantial sum in relation to the total government's tax expectations. So far as the figure in dollars is concerned, I could not tell you how much it will be. I know that any firm I have ever been with bills its accounts and likes to have them paid as quickly as possible and I do not think the amount of tax deferment is substantial in relation to the several milllions dollars collected in tax.

Senator Cook: The treasury would only benefit in the first year and after that it would average out.

Mr. Thom: Yes. One feels that in the whole of the White Paper the attitude is taken that certain unfairnesses and inequities are to be smoothed out and one feels that the approach in taxation of the professions is more from the viewpoint of eradicating an unfairness than from any real injury being inflicted upon the collection of tax.

Senator Molson: Unfair in what sense? Unfair to others because the profession is not obliged to use the accrual system?

The Chairman: That is what it says.

Mr. Thom: We can only regard it as a highly subjective approach to what is fair and what is unfair.

Senator Connolly (Ottawa West): A most undesirable result is that it changes the character of the profession.

Mr. Thom: Yes.

Senator Connolly (Ottawa West): Could I ask this question? Are there any figures which indicate to you the number of people in the profession who practice alone or who practice without being in a firm or a partnership? Do you have any rough estimate?

Mr. Howland: Senator Connolly, I do not have that figure with me, but if it is of interest I would be very pleased to obtain it and furnish it to the committee. I would think it is quite a significant factor.

Senator Connolly (Ottawa West): When you consider the distribution of the members of the profession in the various jurisdictions in the provinces, it must be a considerable number.

Mr. Howland: I think also that it will become much more significant because of the very large increase in numbers of those coming out of law school—that is new lawyers coming out in the next five years. A great number may not be able to find employment with larger firms and they will be going to practice for themselves and filling gaps in remoter communities.

Senator Phillips (Rigaud): Mr. Chairman, should it not be pointed out in dealing with Senator Everett's distinction that putting unbilled work on a so-called accrual basis as distinguished from an account receivable after billing—that in effect an account billed by the lawyer is not truly an account receivable because it does not represent a contractual obligation on the part of the client to pay. It is merely an indication by the lawyer of what he thinks the client should pay him. Therefore, even with respect to billed accounts, there is nothing inconsistent with the position that the lawyer takes, that he should remain on a cash basis. In other words, there is no such thing as accounts receivable in the true sense. You only get an obligation on the part of the client when he agrees to pay.

Mr. Howland: Thank you, senator we quite agree.

Senator Phillips (Rigaud): In other words, there is no such thing as accounts receivable in the true sense.

Mr. Thom: Thank you, senator, we quite agree.

Senator Phillips (Rigaud): You only get real obligation on the part of the client when he agrees to pay it to you.

Mr. Thom: A merchant can take his accounts receivable to the bank and borrow on the strength of them. We can do nothing of that sort; legal firms' accounts receivable are nothing as far as the banks are concerned.

Senator Phillips (Rigaud): A lawyer cannot set out a number of bills and go to a bank and say, "These are my accounts receivable. I have billed these accounts." The bank would pay no attention.

Mr. Thom: I have never heard of it being asked for or done, and furthermore it would interfere with the confidentiality of our relationship with our clients were we to take a list of the people who owed us money to the bank and they said, "Oh, so-and-so owes you so much, eh? " You just could not do it.

Senator Phillips (Rigaud): I simply wanted to make that point clear for the record, that billing in itself does not create an account receivable.

Senator Molson: Mr. Chairman, I would like to get back to this point. We in discussion here a few minutes ago got to the stage of saying that the White Paper proposal really does very little in the way of creating greater tax revenue or greater tax benefit to the state, but that it is perhaps based on a premise that there is some unfairness in the existing system. I thought perhaps we should develop that a shade further. From all that has been said this morning, in fact the only advantage to the Treasury is the acceleration of a relatively small amount of tax, and in order to achieve that objective they are demanding a system which is going to take an enormous amount of work and is going to be extremely difficult to carry out and which, certainly for the smaller professionals, will be quite awkward. You need staff or advice, facilities which today they do not necessarily have; quite a complex system for a temporary advantage of perhaps one year, a slight increase in tax for one year, the advantage then being lost as time goes on, but leaving behind a system which is awkward and expensive.

The Chairman: Yes. following that up, Senator Molson, you realize that "unbilled time", it seems to me, means exactly what it says. That is, the time that was spent and the cost that is assessed against it does not or may not necessarily include any element of mark-up; it is only cost. If you put on the one side the cost and bring it into an inventory as income, and you put on the other side the cost, you may well have offsetting items. Then the result is you do not affect the tax revenues in any way.

Mr. Thom: As Senator Molson has said, and as you have indicated, it would be a very highly complicated method of accounting for people who are not essentially businessmen to achieve a very insignificant result, and also a result based upon data which is in a sense meaningless, because to say that I earn so much every hour of every day is not a sensible statement.

Senator Cook: If the great bulk of the people do not accept it, how is the department going to police it and find out?

The Chairman: Do you mean how are non-lawyers who are investigating going to assess a proper charge?

Senator Everett: I want to follow on Senator Molson's point, and that is the cost of this accrual method in determining what the working process is. I have some small knowledge of that in the service business, and I know it is one of the most difficult accounting jobs you face. The dentists and the architects both say they are not equipped to handle this kind of accounting function, and that they will have to add considerably to their costs to do this; and that cost would be passed on to the client, again, for what Senator Molson says is a one-year tax deferral, so

we are only talking about the interest on the tax over that one-year period. Would you confirm for us that lawyers are not also equipped under the present accounting methods to cope with this and that it is going to add to their costs?

Mr. Thom: With the exception of a scattering of large firms with a long business build-up of experience, yes, the run-of-the-mill, if I may use that expression, or the general practitioner or the single practitioner in the small firm is not equipped to maintain the flow of memos or data required to produce what the department chooses to call an inventory of unbilled time, and they would have to engage new staff and spend a considerable amount of their own time supervising this activity.

Senator Everett: It might be said that in the end the client will pay more than the Government will, in terms of revenue actually received.

Mr. Thom: In the long run it would have to be reflected in the fees charged to a client because that is the only source of the income.

The Chairman: If it is not, that would be a deductible expense and therefore would reduce the amount of your taxable income.

Senator Molson: Mr. Chairman, I would just like to remind you that yesterday in the Chamber of Commerce submission I think Mr. Capon pointed out that most of the major taxation changes in the proposals in the White Paper were going to add to the already enormous cost and complexity of accounting for tax purposes. I think this has been borne out in practically every submission we have had. For example, we have just had it now in considering the law profession in Ontario. We had it from the architects, and we had it from the dentists. I think one of the things emerging at this moment is that every proposal seems to be adding to the complexity and difficulty of the person to account for his tax liability.

The Chairman: Is there anything more?

Mr. Thom: Thank you, Mr. Chairman. The questions have certainly covered all the points in our brief.

Senator Laird: May I just ask one question?

The Chairman: Yes, Senator Laird.

Senator Laird: On page 11 of your brief you seem to contemplate a possible alternative, because here is what you say:

> If it is the opinion of this committee that the blanket permission presently accorded the professions at large to report income on a cash basis is not satisfactory, the Society is prepared to rely upon the well established judicial principal that the income of a taxpayer or group of taxpayers should be determined in a manner which properly reflects the nature of the income produced by the taxpayer's operations.

Suppose by some remote chance we did not agree with your point of view entirely, what alternative would you suggest?

Mr. Thom: One has recourse to the courts and the application of those principles which have been built up in the growth of our income tax system to apply a suitable method in relation to the nature of the business activity. This has been done repeatedly already. In a number of instances the courts have resisted the tax department's efforts to impose a certain method of computing income of the taxpayer and have said that, "The taxpayer's activities are not suited to this concept of determining income, and we have chosen another."

Senator Laird: Would you contemplate any sort of hybrid system?

Mr. Thom: When that sentence was written, senator, I can tell you from what I see that the courts would support that tax method of reporting income.

Senator Laird: That is really what you had in mind in making that observation?

Mr. Thom: Yes, that is really what we had in mind.

The Chairman: Mr. Thom, before you go may I ask if you are putting forward as part of your presentation the brief that has been filed by the McLaughlin firm?

Mr. Thom: No, senator, we are not. Mr. Morden was not able to come here today.

The Chairman: The brief they have filed is based upon this question of accrual accounting for tax purposes.

Mr. Thom: Yes.

The Chairman: I take it that there is nothing different in their brief from what you have already said.

Mr. Thom: I should not say there is nothing different in it, but it perhaps expresses the ideas in slightly different language.

The Chairman: But it is directed to the same point.

Mr. Thom: Yes.

Mr. Howland: The only thing, Mr. Chairman, is that Mr. Thom has spoken of the impact on certain large

firms, and the McLaughlin firm falls into that particular bracket. I do not think they are representative of the run of the mill general practitioner—the small firm and the individual practitioner—across the province.

The Chairman: Of course, I have never accepted the argument that because something will not hurt you it should be, therefore, brought into force. There must be some justification for it on the merits. The bigger firm may have working capital that enables it to carry this on, but you must still keep to the principle of the thing.

Mr. Thom: Yes.

The Chairman: In its method of operation the accrual method applied to professionals—in this case, lawyers—is it a proper method of accounting?

Mr. Thom: Yes.

Senator Isnor: I should like to ask one question. Have you any figures to show the numbers of law graduates immediately entering into practice on their own account, Mr. Thom?

Mr. Thom: For Ontario?

Mr. Howland: I think the nearest figure we can give you, senator, is that at the present time out of the 7,000 who were in practice before this last call to the Bar in March, about 5,500 are actually practising law. Others may have been in business or executive positions.

Senator Isnor: Are they practising the law as individuals, or with firms?

Mr. Howland: It would be a combination of both. As I explained to Senator Connolly, there is a significant and large cross section who practise alone. Then there are the two and three man firms, and then we graduate up to the large firms in major cities.

Senator Isnor: Senator Phillips raised the important point of bills receivable not being considered as assets. Does that apply to all legal firms?

Mr. Howland: Yes, it would.

Senator Isnor: How do you look after the estates of persons who leave large amounts of bills receivable?

Mr. Thom: When the work has been done, senator, you go to the beneficiary and say: "We think our services are worth so much." The beneficiary will agree, or he might say: "I would prefer to have the court set the figure", and if so then you go to the court and pass the accounts of the estate. In the course of so doing the court allows the solicitor a fee for what he has done. Until that time the solicitor has literally earned nothing, in a legal sense.

Senator Isnor: But he has to take into account the value of those bills receivable, does he not, in establishing the value of the estate of the client?

Mr. Thom: His own bill?

Senator Isnor: No, the bills receivable.

The Chairman: Senator, we have had explained here this morning that an account receivable of a legal firm is not an account receivable as you might understand it in a commercial sense.

Senator Isnor: That is what I am trying to establish. It is hard for me to think of a law firm that is looking after an estate not taking into consideration the value of the bills receivable of clients.

Mr. Thom: I think it is done in some of the larger firms that can afford the staff to do the detailed work, in order to see how they are making out and whether they are above or below the profit line. They will keep some record of what they expect to charge.

Senator Phillips (Rigaud): It is merely a memo of what they expect to get, but it does not constitute a legal claim.

Mr. Thom: It is a regrettable fact that many lawyers do not keep that record.

Senator Phillips (Rigaud): We do not want you to tell that to all our clients across the country, Senator Isnor. It may affect our right to collect.

The Chairman: Thank you, Mr. Thom and Mr. Howland.

The Chairman: We shall hear now from the Bar of the Province of Quebec which is represented by Mr. C. Gagnon, the Bâtonnier of Quebec, and Mr. P. Vineberg, the Bâtonnier of Montreal.

Mr. C. Gagnon, Q.C., Bâtonnier of The Bar of the Province of Quebec: Mr. Chairman and honourable senators, I wish merely to say thank you on behalf of the Bar of the Province of Quebec for allowing us to appear before you. We feel we are fortunate in having as our spokesman this morning Mr. Phillip Vineberg. We believe he is an expert in the field. I should like to mention that he is also the Bâtonnier of Montreal, and Vice-President of the Bar of the province.

Mr. Philip F. Vineberg, Q.C. Bâtonnier of the Bar of Montreal: Mr. Chairman, I might say at the outset that

we find ourselves very much in the same position as Ontario, only more so. That is to say, everything that Mr. Howland and Mr. Thom have explained about the impact of the proposals in the White Paper on professional men would apply all the more in the Province of Quebec, for a number of reasons that had not occurred to me until I listened to the discussion this morning.

First of all, without having the statistical evidence but on the basis of impressions, I believe that the proportion of lawyers practising alone or in smaller firms is greater in Quebec than it is in Ontario.

Secondly, our legal aid system is on a rather different basis in view of the fact that practising members of the Bar must perform their legal aid service gratuitously, whereas in Ontario it is on an organized Government basis. For example, in the City of Montreal alone last year over 1,032 lawyers, representing more than 50 per cent of the total, handled well over 3,000 cases free of charge and without any payment. They were not only requested to do so but they were obliged by our code of ethics to accept any mandate submitted to them unless there was some justifiable reason for not doing so.

Thirdly, in Quebec we do not know the system of the taxing officer as explained by Mr. Thom. To our ears it sounds rather strange because it is surrounded by an aura of certainty by comparison, because in Quebec we have much uncertainty. It is true that we have the fixation of what are called judicial tariffs. The amount payable by the losing party when the costs are determined is a very, very small amount when compared to the legal costs involved.

In so far as the main aspect of legal fees is concerned, whether in litigation, estates, or otherwise, we are completely dependent upon negotiation, revision, and ultimate determination. There is no recourse to any taxing officer.

I might add also that when a bill is submitted it is not an uncommon practice for people to raise questions about it. I think it is fair to say that some bills are always paid, and some bills are never paid.

Senator Laird: Pardon me, but can you not sue in the courts?

Mr. Vineberg: Yes, that is the ultimate recourse, but the courts are not bound to accept a bill. They are the final determining party. I might add, senator, that there is a fair number of lawyers who never sue. I myself know many who, irrespective of the amounts owing them and the importance of them, will not institute legal proceedings. They would rather renounce their fees than get involved in the litigation that would be related to it.

There is also a procedure much used whereby anybody who has a complaint about the quantum of a bill is entitled to ask for arbitration, and the bar frequently has arbitration tribunals sitting. Last year a client from England protested the bill, and there was a long arbitration. I would say that in the vast majority of cases the arbitration award is less than the amount of the bill. Sometimes of course the bill is maintained.

Senator Laird: Is that binding?

Mr. Vineberg: It is part of the agreement that before the bar will accept arbitration both the lawyer and the client must agree to accept it.

Senator Connolly (Ottawa West): The former client!

Mr. Vineberg: Probably. I think that point is well taken. The ex-client perhaps. That is certainly the case.

Finally, I might point out that apparently in Quebec we have gone further than is permissible in the common law provinces in the direction of making possible a provision for fees which is related to the results to perhaps a greater extent. We are not allowed a contingency arrangement in the formal sense of the term; particularly, we are not allowed to renounce our fees. But we are allowed to make arrangements, as for example in automobile accident cases, where the amount of the claim and the results achieved will determine the amount of the fees payable to the lawyer. Therefore, as at the end of the fiscal year he obviously does not know whether he will win or lose the case, and he does not know the quantum of the damage he will be able to obtain for his client if he is successful, so the possibility of computing what he may earn out of any particular case becomes more and more obscure and uncertain.

Senator Connolly (Ottawa West): I do not want to interrupt your train of thought, but because litigation is a very important item of your practice, in Quebec especially would you touch on the slowness with which cases are heard.

Mr. Vineberg: I was just coming to that. It seemed to me—and again I am not particularly proud of it—that in the Province of Quebec the delays are inordinate for a vast number of reasons, including of course the degree to which the Quebec public, the Quebec bar and Quebec society is litigious, and the inability of the courts to deal with the vast array of litigation that presents itself. Consequently, there are many types of cases that take three or four years before adjudication, even at the primary level, to say nothing of what will happen at appellate jurisdictions. At the present time in the City of Montreal it takes something like 36 to 40 months on average for a case to be heard from the time it is instituted. That is not so for cases of a special emergency nature or summary action, or certain kinds of automobile cases that are

heard more expeditiously. However, on average, statistics released only a couple of weeks ago by the Chief Justice in Montreal indicate 36 to 40 months before a case is heard.

Again, therefore, when a lawyer is performing work he has to be in pretty good health and have a good life expectancy, as well as being able to determine what the outcome of the case will be, in order to have any concept of what he will earn. That concept, I would submit, would not be well founded or scientific.

Indeed, if I might perhaps explain why I think the authors of the White Paper said when they did, I think they were not particularly addressing themselves to this problem that we are discussing. It is not that they are seeking to ignore it or refute it. It is rather that they were preoccupied with something that has a relationship to the legal profession, only possibly in the upper echelons of corporate practice. That is to say, there are some professional firms, not in law, that can virtually operate on a computerized basis. That is to say, they would have, by some kind of mechanical registration, the amount of time spent by juniors, intermediates and seniors, all of whom are graded at so many dollars and cents per hour, and at the end of the period and the ultimate end of the machine there comes out the amount that will be billed to the client. No lawyer can do that. No lawyer has ever done it. However, I am told that there are certain professions where things like that have been done. Of course, where you are limiting yourself to corporate clients as compared with serving the broad general public it becomes possible to conceive of that situation.

I am going to try, honourable senators, to avoid trespassing on your time on matters that have already been covered. I want to say, of course, that we as members of the Bar of Quebec are interested in everything in the White Paper, not just this subject. Our interests have been reflected by co-operation with the Special Committee of the Canadian Bar Association, with which Mr. Thom and I, for example, are associated, and our general views on other aspects of the White Paper will be presented conjointly with that of the Canadian Bar Association.

We therefore want to come to you to ask you to consider just what is the justification for the cash basis as it is now adopted, and what is the justification for the alternative. It is not to be imagined that what we are proposing is anything unique. It is rather that the White Paper is submitting a rather unusual, unique and if I may say so respectfully, eccentric idea. I do not think it is eccentric in relation to what they were thinking of, which is the entire professional community as a group, but it is eccentric in its application to individuals, to individual professional persons, to individual members of the public, to the client and to the broad mass of society. After all, we have had an income tax system from 1917 onward. Other countries have income tax systems of older vintage. Professional men have always reported their income on a cash basis. It is not the wisdom of 1970 that is so different from all time and in all places. We are not the only country in the world to have an income tax system. There is no place more sophisticated in income tax litigation, legislation and draftsmanship than the United States of America, and there the lawyers are filing on a cash basis.

There is no centre of the legal world more susceptible to computerization than New York City, where they have law firms of 100, 150 or 200 in a single firm, and where by contrast with what prevails in Quebec there is a great deal of centralization. None the less, as far as I know, nobody in the United States has ever seriously proposed anything but the cash basis, and they follow the cash basis. In England they follow the cash basis; in France they follow the cash basis. As far as I have been able to ascertain, the cash basis is followed everywhere in the world. It has been followed in Canada, and it is the only system that has been followed.

It may be said that perhaps that arose because of oversight, they did not notice anything, they were not aware of the fact that this supposedly provides an "unwarranted advantage". But as Mr. Thom pointed out, this specific subject was reviewed by Parliament in 1955 when it introduced section 85(f). At that time, so far as I am aware, nobody, seriously or otherwise, proposed any change under which professional men should return their income on an accrual basis. It has always been on a cash basis, and it was as a result of review and consideration that they reaffirmed the position on a cash basis. Thus it is that the present rule is not simply the product of historical accident. It has been reaffirmed after careful consideration by Parliament, when this particular subject was analyzed—and I say this particular subject by comparison of course with an overall review of the entire tax system, not addressed exclusively to the subject of professional returns.

I would point out that the vast majority of Canadians file returns on a cash basis—the overwhelming number of them—there are very few exceptions. The Carter Report—which is after all the one which inspired the White Paper on this—itself points out that it would create some hardship if one were to expect of all professional individuals that they adopt the accrual system.

There has been some interrogation this morning as to the meaning of the phrase that the "concession has given professionals and unwarranted advantage by comparison to the rest of Canadians."

I would respectfully submit that it is neither an advantage nor a concession, nor anything unwarranted at all. In so far as total taxable income is concerned, it is quite probable that a professional man, if he can survive, will pay less taxes under the accrual system

than he would pay under the cash system, for the reason that the young lawyer setting out in practice usually does not earn very much, and he gradually earns more and more as time goes by, so that if he follows the cash system he will, in subsequent years, when his tax rates are higher, have to pay more taxes than would have been the case if he followed the accrual system.

The only difference is that he pays the taxes when he has money to pay it, when he has the ability to pay it, when he has the receipt. Under the proposal, he would be obliged to pay the taxes before he got the money. He would be obliged to accrue the income.

As you can well understand, a young lawyer starting out in practice finds that the proportion of his non-paying to his paying clients, and of his slow paying to fast paying clients, is much higher than that of someone who has attained eminence in the profession. He would be most hit at the worst time. If he can survive, if he can borrow money for the purpose, in the end result he pays less. It is only a question of time.

If you look at the position of lawyers and professional men generally, this "unwarranted advantage" strikes strangely in our ears. First of all, as the Minister of Finance has repeatedly asserted, both before this committee and before the House of Commons committee, in dealing with small corporations, that professional men are not allowed to incorporate. I am not saying that as a complaint. There are some 50,000 professional men. If businessmen find it advantageous fiscally to incorporate, they will do so. They have been able in the past to get a low rate–23 per cent 21 per cent in some provinces–on the first $5,000 of income. Lawyers and other professional men are precluded from doing so.

Secondly, as we are not able to incorporate, professional men have been unable to participate in the pension and other fringe benefits available in corporations. They are self-employed and are therefore deprived of certain advantages–with the sole exception of the legislative retirement plan.

They are unable to take advantage of section 18 of the Income Tax Act, which allows a kind of combination of accrual and cash basis between a salaried employee and the corporation itself.

Moreover, if you were to look–and I shudder at the thought–that a professional man, as compared with a businessman, a professional man spends the better part of his youth learning to become a professional man. He must devote a great deal of time, effort and money. In Quebec it is eight years at the university level today, after the primary and secondary studies. During that period of time he expends much effort. But, unlike the businessman who makes a capital investment, he is not allowed to write that off against income. I am not suggesting he should be allowed to write it off.

He usually starts–and this is increasingly by typical, in the case of your professional men–indebted, and he has to pay off a good deal of that expenditure which enabled him to become a professional man. But there is no write-off as a businessman would have had in an equivalent business case.

In that sense, we find it hard to understand why it has been stated that the professional man has had an undue advantage or unwarranted advantage by comparison with other taxpayers.

Senator Laird: And he pays his debt in taxpayer's dollars?

Mr. Vineberg: Yes, I quite understand that the cash basis would normally seem most desirable for the professional man and everyone–it sounds fair and just to say, you pay taxes when you have the money.

Indeed, as Mr. Thom mentioned this morning, the learned President of the Exchequer Court, in the Trapp case–it was suggested that is the best thing to do, even in business. There is a good solid reason why a special rule had to be created in business circumstances, and that reason arises precisely because of the inventory question. In a business, the inventory of merchandise is expendable and deductible, and the merchant is entitled, if he wants, to accumulate as much inventory as possible. If you do not have the accrual system of accounting, a businessman, by the constant excessive accumulation of income–which, after all, is purchasable at will and is not dependent upon sales or contracts–can augment his deductions and postpone his tax.

That is not so for the professional man.

I have been practising law for 30 years. Until I read the White Paper I never heard of inventory in relationship to professional practice. I thought at first that it had to do with the large amount of paper we had in the office–that is the only kind of thing that I knew as inventory. That paper amounts up to a phenomenal degree, because our material physically is composed of it, of agreements and financial documents and contracts. That is what our business is. It does not have in itself much money value, and we do not sell paper. So we do not have a stock in trade or inventory. Therefore I think it is an artificial expression to refer to it as inventory.

It seems to me that that is one of the very important aspects.

Senator Isnor: It has this to your advantage, that you do not have to worry about over-levying.

Mr. Vineberg: No, because we are pretty sure that it is going to be used up quickly. And now, with Xeroxing, that adds greatly to the amount of production of paperwork.

One of the important aspects of this situation is this, it is not the professional man but the public, the client–and I would ask you to consider certain aspects in relation to it.

As I pointed out in Quebec, as elsewhere, lawyers spend a good deal of their time working first on legal aid, where there is no payment. They must, either by choice or otherwise, have a great deal of work done for members of the public.

What I am about to say does not apply when retained by a large corporation. Perhaps the larger the corporation the more inclined it is to accept as reasonable the fees you would charge.

But when retained by individuals who have problems, it would be a very shocking thing to a lawyer to contemplate that the moment that the client walks into his office, he thereby as a lawyer has contracted an obligation to the tax department by spending some time with that client. Because, after all, there are a number of clients in respect of whom you know that no income would be received.

Are we going to try to encourage or force on professional men the mentality of saying, better collect in advance, because you have to pay something to the Income Tax Department?

It may mean that the lawyers who are the most exacting, who exact the most money, who are the most aggressive–who are the most unethical, really–will prosper most under the accrual system. Such lawyers will get paid in advance.

Perhaps, under the accrual system he would be entitled, to a degree to which it is not now available, to defer a portion of what he gets into income of succeeding years, so that he would pay less–the more he would collect in advance, the less taxes he would have to pay.

The lawyer who wishes to be fair and reasonable, recognizes that members of the public have certain rights, they are entitled to services whether or not they can pass a means test, that they should be fully serviced irrespective of whether they made any payment in advance–he will be prejudiced, because the longer he withholds the initial demand for money, the more taxes he is going to have to pay, irrespective of whether or not he is collecting from the client.

So this idea, the accrual system, will encourage the maximization of collections in advance. It will also encourage the very aggressive, somewhat businesslike practices, about collection of accounts receivable.

As I say, the standards vary. There are some lawyers, admittedly, who may be very exacting about accounts receivable. There are plenty of lawyers who will ask for payment in advance.

But there are also situations where lawyers will not do so, they will tolerate long delays, they will not be inclined–because it is not a very delicate thing–to send out Monthly reminder letters.

I have never heard, for example, of a lawyer who would charge interest on an account receivable, and I never heard of the discounting of an account receivable on a 30, 60 or 90-day period.

It seems to me that the whole burden of the accrual system is shocking to the professional man, precisely because it proposes to introduce rather aggressive standards vis-a-vis the public.

The Chairman: Right on that point, I was wondering. I put time charges in for services to a client and then I decided somehow that I was not going to make a charge. Then I am paying for my generosity. I am going to be paying income tax on that.

Mr. Vineberg: Yes, except for this, that if the clients inability to pay is due to his insolvency, or near insolvency, then perhaps you could be able to defer your taxes or eliminate them, by taking the reserve for doubtful accounts, but the rule does not apply only to doubtful accounts and very often there are cases where the work is performed and he fee is not charged, for charitable reasons. And it has nothing to do with accounts that are doubtful.

The Chairman: How do you have doubtful accounts in relation to unbilled time. If there is no bill, there is no account.

Mr. Vineberg: I do not really know. I cannot conceive of unbilled time as being worth anything measurable. And I cannot conceive of anybody seriously wanting to spend time to measure the immeasurable–when it is going to be known so quickly.

After all, if I can put it this way, you could trust to the selfish nature of man, including the professional man. He has an interest in getting paid. I do not want to draw up a picture of a lawyer sitting back and deciding to dispense his services to the public indifferently. Lawyers have all kinds of expenses, they have accounts to pay and they have bills to meet. Lawyers will be anxious to get paid in an expeditious way as far as they can. So I do not think we need fear that the lawyer is going to sit back and wait for years and years to collect his fees. Any lawyer who does that knows that he is imperilling the fee altogether. There are clients who forget, there are clients who do not pay, clients who

die, clients who move away, and there are bills that are forgotten and there is no contractual agreement and they disappear with the passage of time. It is wasted effort at that point.

There is one point I might mention here also. I think of the shuddering concept, quite apart from the worthlessness of it all, how does the Income Tax Department come in and discuss this unbilled time? Do they rifle through the files of clients? Do they want to know who is suing whom?

Do they want to assess the merits of the defence? Supposing there is a defence case with the Income Tax Department, are they going to be entitled to know how well you prepared the case is and how much time you spent on it?

Senator Connolly (Ottawa West): That is privileged.

Mr. Vineberg: That is what they might do. Are you going to allow Government officials to look through all the files of all lawyers, so that no longer will people be able to trust a lawyer so that they can tell him what is privileged.

The whole purpose seems to be shocking, by comparison with normal business requirements.

Senator Isnor: The same thing applies to a businessman.

Mr. Vineberg: Except that they are not in a professional category. The businessmen are not the repository of secrets of the public.

The lawyer is dealing with other people's affairs, affairs entrusted on a confidential basis. Those affairs are largely made up of many confidential matters.

It seems to me we are not dealing with any question of Government revenue, that rather Government revenue would decline with the adoption of this, to some degree, for the reason that a great deal of administrative effort would be wasted and dissipated. Also, for the reason that lawyers would have to spend a great deal of time drawing up records needlessly, and the end result would be that they would have less income than before.

Also, there is no question that under the accrual system you pay taxes on accrual income. It is only a question of when, and it is, on the whole, only in the initial years.

The final point I would like to make is of course that the system is most disadvantageous to the lawyers who are practising alone, to younger lawyers, to lawyers in the early stages of their careers, and that there are no compensating benefits available to the Government by the supposed imposition of the accrual system.

Senator Phillips (Rigaud): Mr. Vineberg, I would like to put two questions to you. The first is, if lawyers were obliged to compute their income on an accrual basis and if in certain instances the lawyers decided not to charge the client at all—and this happens very often—would not the lawyers be exposed to the charge that they are evading tax?

Mr. Vineberg: Yes, I suppose that is possible.

Senator Phillips (Rigaud): It could be very troublesome under the enforcement provisions of the Income Tax Act.

Mr. Vineberg: It may be, under those circumstances that the lawyer would be taxed on income he should have received and would be subject to gift tax on the disposition of the benefit he has conferred on a third party.

Senator Phillips (Rigaud): And, even worse, he could be obliged to pay gift tax and could even be charged with having evaded taxable income.

The Chairman: And having made a false return.

Senator Phillips (Rigaud): Yes, and having made a false return.

Senator Isnor: Unless they did it as a gesture of goodwill.

Senator Phillips (Rigaud): I would not like to rely on the sense of justice of the enforcement officer.

The second question I would like to put to you is this. Coming to the White Paper again, to paragraph 5.46, where it is proposed that lawyers should be assimilated to businessmen, in view of the fact that businessmen are entitled in respect of capital assets to depletion allowances, obsolescence and depreciation whenever the applicable terms are properly used, would you not think that lawyers, on an accrual basis, would be justified in taking the position that their capital asset being their mental apparatus they would be entitled, as business people, to depreciation or obsolescence?

The Chairman: First of all, to capitalize.

Senator Phillips (Rigaud): Yes, to capitalize first of all: (a) the eight years spent in preparing for the profession. And, (b) our mental apparatus being the instrument of our earning power, that we would be entitled to depreciation and amortization and, as we get older, obsolescence?

Mr. Vineberg: It is not only as we get older, senator, but as the law changes and we have to learn new law.

Senator Phillips (Rigaud): I want to put this question to you in order to reach the *reductio ad absurdum* of the assimilation between a professional man and a businessman.

Senator Connolly (Ottawa West): You are speaking for the legal profession in Quebec, but for the advocates' side only, I take it?

Mr. Vineberg: Do you mean by comparison with the notaries?

Senator Connolly (Ottawa West): Yes, by comparison with the notaries.

Mr. Vineberg: Yes.

Senator Connolly (Ottawa West): Will the notaries be making any special presentation?

Mr. Vineberg: I am not aware that they will. The notarial profession has not discussed with us their own position. I would think it would probably be similar to ours.

Senator Connolly (Ottawa West): How many advocates are there, as opposed to notaries, in Quebec?

Mr. Vineberg: There are now about 3,500 lawyers or members of the Bar, and about 1,200 notaries in Quebec.

Senator Connolly (Ottawa West): For the most part, as I understand it, except in rare instances perhaps in Quebec and Montreal, these notaries practise alone, do they not?

Mr. Vineberg: Yes, except in Montreal and some of the larger centres. On the other hand, the notary is subject to a more rigid tariff, and what the notary will charge is more determinable in advance than that of the lawyer.

Senator Connolly (Ottawa West): Because of the tariff?

Mr. Vineberg: Yes, because of the tariff system.

Senator Connolly (Ottawa West): Because of the tariff imposed . . .

Mr. Vineberg: . . . by the notarial profession.

The Chairman: Is that tariff on a time basis?

Mr. Vineberg: No, not at all.

Mr. Gagnon: It is a minimum tariff, though it is a very good guide as to what a notary would charge.

Senator Laird: But it is increased from the minimum under certain conditions?

Mr. Gagnon: I am not that familiar with it that I could comment on that, but my understanding is that it is a minimum tariff for certain deeds and according, sometimes, to time spent and the amount involved, but it is quite accurate.

Senator Connolly (Ottawa West): A very important question for Ontario and Quebec is that they are required, for all practical purposes, to take some training as a lawyer.

Mr. Gagnon: Yes, they go to the same university and it is only their last year that is different.

Senator Connolly (Ottawa West): So that the record that was made when the representatives of the Law Society of Upper Canada were here before us a few moments ago, in connection with the professional character of the work that was done by the individual lawyer in Ontario, applies equally, not only to the advocate practising alone in Quebec but as well to the notary?

Mr. Vineberg: That is correct, senator.

Senator Flynn: There is a difference in the case of the notary, that he takes less time than a lawyer. They have very few cases which will last for years and years.

Mr. Vineberg: Yes.

Senator Lang: As with some of the sections of the White Paper I find it difficult to ascribe to the authors an utter lack of comprehension, I wonder if there is any practice or are there any practices in the profession which give rise to this assumption that we have an unwarranted advantage? I wanted to ask Mr. Vineberg if he could conceive of any way that a professional man could seriously abuse the cash basis method?

Mr. Vineberg: The Minister of Finance has actually mentioned two items in relationship to that. First of all, he has referred to the practice which he said arose in some cases where lawyers place money in trust accounts—that is, collection account matters or others—and did not put it into their taxable income except at a later period. He has pointed out, however, that this was an abuse which has been corrected by an administrative procedure and, in any event, it seems to me it has nothing to do with the cash basis versus the accrual system, because it is an abuse which is more likely to occur under the accrual system than the cash basis. The lawyer on the cash basis who receives money puts it into income and the lawyer who is on an accrual basis

will be able to argue that this is money that is going to be earned in 1975 and therefore he is deferring, and the depreciation problem has been cured.

The second point raised by the Minister of Finance is that some professional men have adopted a fiscal year different from the calendar year, and as a result it includes even the earlier years of practice. That might terminate their fiscal year, let us say, in January and not be subject to tax in the earlier period. That is a feature inherrent in the entire tax system. It is not unique to professional men alone, and in that sense the adoption of a fiscal year end rather than calendar year end may entail conceivable advantages for them to adopt it, by comparison with the others who do not. That is not unique to professionals and is rather less likely to occur among professional men than businessmen, generally.

The Chairman: But any proposal to change the fiscal year, once you have established it, comes to the knowledge of the tax officials?

Mr. Vineberg: Yes, you cannot change without their approval.

Senator Phillips (Rigaud): You need consent to do it.

The Chairman: Yes. Apparently there are no other questions, so thank you very much, Mr. Vineberg and Mr. Gagnon.

The Chairman: We shall now consider a brief that departs from the question of the cash accrual method of computing income, and it is from the Retail Council of Canada. To present this brief we have Mr. McKichan, General Manager of the Retail Council of Canada. I will ask him to introduce his associates.

Mr. A. J. McKichan, General Manager, Retail Council of Canada: Mr. Chairman and honourable senators, I wish to express our pleasure at being invited to appear before you today. On my immediate right, Mr. Chairman, is Mr. Knechtel of the T. Eaton Company; on his right is Mr. Hall of the Robert Simpson Company; on his right is Mr. Cronkwright from Clarkson Gordon and Company. Then there is Mr. Moffat of the S.S. Kresge Company, and Mr. Gaynor of Stag Shops of Hamilton, and who also represents the Board of Directors.

Mr. Chairman and honourable senators, if it is your pleasure I would propose to proceed by dealing with each main section of our submission in turn, and suggest that discussion take place on it before we move on to the next, because our submission covers pretty well the whole range of the White Paper, and it might be difficult to come back to a specific section.

The Chairman: Is this in summary form?

Mr. McKichan: Yes.

The Chairman: Very well. I should interject at this stage that I have just received a letter from the Retail Merchants Association of Canada Inc. which endorses the presentation you are about to make. I think this letter should be entered as part of the record.

Senator Phillips (Rigaud): Do they associate themselves with the brief, Mr. Chairman?

The Chairman: Yes. I will read it. They say in part:

> The only exception to these endorsements in the foregoing is a separate submission recently made by Retail Merchants Association of Canada (Saskatchewan) Inc., which is probably in the hands of either Committee at the present time. This decision was made so that we might have less submissions submitted to the Senate Committee and the Commons Committee that would, in the main, project the same thinking but in a variety of ways and in this way we feel that we will, perhaps, contribute toward lightening the load of the Committees and yet find expression of the needs of our membership relative to the Government "White Paper" on "Proposals for Tax Reform".

Generally, I would say, it can be taken as an endorsement.

Mr. McKichan: In that same vein, Mr. Chairman, I have also been asked to report on behalf of our affiliated associations. Perhaps I should mention that the direct members of the Retail Council consist of the major and medium sized retailers in all specialties in all parts of the country, together with a cross section of the smaller members of the industry, but in this case particularly in the men's and women's fashion trades, where there is no special. . .

The Chairman: Of the first grouping can you give us any estimate of numbers?

Mr. McKichan: There are some 280 members in that category who, among them, operate some 6,000 retail outlets in Canada, and account for approaching 40 per cent of the total retail store business in Canada.

We also have affiliated with us most of the specialized trade associations, and of these affiliates I have been requested to express endorsation from the

Canadian Restaurant Association, the Canadian Show Retailers Association, and the Canadian Paint and Wallpaper Dealers Association. Others of our affiliates indicate that they will probably also be endorsing our submission, but they require to go through the machinery of obtaining permission from their boards of directors and so forth.

Mr. Chairman, in approaching the White Paper, we have attempted to follow the advice of the Minister of Finance in wherever possible offering a suitable alternative to the proposal of the White Paper. We have, of course, also attempted to deal most fully with those aspects of the White Paper which have bearing on our own trade, either directly or indirectly.

Turning to the text of our submission, Mr. Chairman, we mention under "Scope of this Submission" that two particular aspects of the White Paper proposals strike with some vigour at the retail trade. One of these relates to the treatment of accrued capital gains, and the other relates to the treatment of small business. In making these points with particular emphasis we in no way wish to downgrade our comments on other aspects of the White Paper, but these affect us with particular vigour. When we deal with small business I would ask your indulgence to allow Mr. Gaynor to speak on that topic, because in him you have before you a real live, breathing, successful, small businessman.

The Chairman: I can tell you that we have been very interested in that subject, Mr. McKichan.

Senator Phillips (Rigaud): The two items are 7 and 12, are they not?

Mr. McKichan: Yes.

Senator Phillips (Rigaud): That is, Items 7 and 12 on the first page of your brief–Item 7 concerning capital gains and Item 12 concerning rate of taxation of corporations?

Mr. McKichan: Yes, sir. On page 2 of our main submission, in main paragraph 3 we deal with criteria for judging a tax system. In summary, we conclude that the White Paper's assessment of what a good tax system should constitute and be, and our own, are not too far apart, but we do point out that we have some differences of opinion as to how the recommendations of the White Paper might match up to those criteria.

In the main paragraph 4 we deal shortly with the point, that has been made very frequently, in relation to a comparison of the White Paper recommendations to the systems prevailing in other countries, particularly, of course, in the United States.

While we do not wish over-emphasis to be placed on our point we do take the position that any system which widens the gap which exists between the United States and Canada can conceivably–and I emphasize that we are not being adamant or intransigent on the point–encourage emigration to the United States and would eventually redound to the disadvantage of this country.

The Chairman: You are not relating this to goods; you are relating it to people?

Mr. McKichan: Yes, sir, to people.

The Chairman: Yes.

Mr. McKichan: We know that a substantial gap already exists simply because of the different sizes and strengths of the two economies, and there is not a great deal that any tax system can do to lessen that gap. On the other hand, a system which tends to lessen the rewards to the creative elements in a society is, we feel, not a positive step.

In paragraph 5, Mr. Chairman, we deal with the administration of the White Paper proposals, and we do make the point–and we wish to make it with considerable emphasis–that the very elaborate, very new, and very complicated proposals which the White Paper plans to introduce would have a very serious disruptive effect not only on the members of our association as businessmen but on their advisers and on the whole tax process.

We suggest that because of this the introduction of the new proposals be placed with the ability of the community in general to absorb them. I think it is fair to say that our members view with real apprehension their problems and the problems of their advisers that will result from the imposition in one fell swoop of a new and elaborate tax system.

Perhaps Mr. Cronkwright might care to add something here.

Mr. G.E. Cronkwright, Clarkson Gordon and Company: This is an aspect of the tax reform proposals which gets very little attention in the White Paper, in view of the administrative problems that it creates. I suspect you have had a number of indications of the complexity many of the proposals will clearly cause. We can look back at the changes made in one industry, the life insurance industry, where there was a situation in 1968 when the industry was told it was to be taxed on much the same basis as other financial institutions with effect two and a half months later, as of January, 1969. It was not until the summer of 1969 before that became the law of the land; throughout all 1969 while this industry was subject to tax they were working with the finance people to work out the

details and it was only in January or February of 1970 that in fact they had detailed regulations under which to determine the tax for the preceding year. That is just one industry and one change.

If you multiply that, with the complexities on capital gains taxation and integration, and new concepts for trusts and professions, as you all heard this morning, it seems to us that this cannot possibly be brought in and understood in one fell swoop. People just cannot cope with this quantity of change. Take a very simple change, such as the provision to allow a deduction or unemployment insurance contributions and have the benefits taxed. On the surface this sounds very logical and straightforward. If you look first of all to the requirements of employers to provide advice to all their employees on how much was in fact deducted from their pay and what was their contribution, all the changes made will require something akin to the T.4 reporting, presumably, so they know how much to deduct in preparing their tax forms. So far as I know, there is just no method yet in place to report to a beneficiary what he has in fact received. Presumably the person receiving benefits is among the group who keep meagre records, and will need some advice at the end of the year to know what benefits he got. When you start multiplying all these changes through the system, we have serious reservations about the ability of people to compute and put the machinery in effect to deal with all the changes.

Mr. McKichan: Perhaps I might add that where in paragraph 0.4 we say:

> It seems to us not at all unreasonable to propose the phasing in of integration of corporate/shareholder income one year, a capital gains tax the next, and so on . . .

we do not necessarily imply any phasing in should be done in this order. In fact, probably the phasing in should not be done in that order. We merely say that it should be done in a logical order, and perhaps spread over a period of years.

Turning to our next point, paragraph 6, dealing with the level of tax flow, our members have been concerned, and we gather that other groups have adopted essentially the same position, that the White Paper proposals constitute a fairly massive transfer of income from the private sector to the public sector in advance of any public discussion of what can become of that revenue. We feel this is the wrong way to approach the situation, and our recommendation is that there be a discussion of rates which would be in place when the taxation system is mature, and that any interim gathering of revenue according to need be done by way of a temporary surcharge, which is labelled as such.

Senator Connolly (Ottawa West): As the need arises.

Mr. McKichan: Yes.

The Chairman: As an interim basis.

Senator Connolly (Ottawa West): Yes, an interim step, and as the need arises.

Mr. McKichan: I think it might be of interest to hear from Mr. Gaynor on this point, who I know personally has strong feeling on it.

Mr. H. Gaynor, President, H. Gaynor Limited: As a sort of maverick of the small businessman still believing in some of the verbiage of free enterprise and personal effort, it has been very disturbing to my friends and people I represent, people like myself, to feel ourserves suddenly faced with a really totally different attitude towards us by the present suggestion. We find ourselves disadvantaged at all levels. The feeling has been—it is not specifically stated in the brief, but I have discussed it with the other members of the panel—that really there is a change of attitude, a change of philosophy involved, which is quite definitely different from the one we were led to believe in when we built our business and created our particular avenue of venture. This has not perhaps been fully discussed, and not even understood by many.

The Chairman: What is your business, Mr. Gaynor?

Mr. Gaynor: I am in the soft goods business. I have two men's goods stores and a ladies' goods store, operating as a small independent retailer.

The Chairman: In the Hamilton area?

Mr. Gaynor: Yes, in Hamilton.

Senator Connolly (Ottawa West): How long have you been in business?

Mr. Gaynor: Eleven years. I came to this country via Austria and England. I came to this country mainly for the reason that I felt this country had fine opportunities to offer a young man, as I was at that time. I meant to go into business for myself, which I did, and this business has flourished to a certain point.

Senator Connolly (Ottawa West): For the record, Mr. Chairman, I think we should say that the representations being made here today are being made for the most part by relatively young men. As I look at them, I think they are perhaps the youngest group we have had before us since we started to sit. Are you primarily involved in small businesses?

The Chairman: No. There is Kresge and others similar. There is only one small business as such, which is Mr. Gaynor.

Mr. McKichan: Mr. Knechtel is from T. Eaton and Company, Mr. Hall is from Simpsons.

Senator Connolly (Ottawa West): They are not small businesses. Still, the younger man, as you mentioned, the imaginative, creative man, is the reservoir of that kind of talent, and that is the age group of the people before us here today.

Senator Burchill: I did not get the nature of the business this gentleman is in.

The Chairman: Soft goods.

Mr. Gaynor: I have two men's specialty goods stores and a ladies' specialty goods stores. They are independent stores owned by myself and built by myself.

Senator Lang: Did you purchase them as a going concern?

Mr. Gaynor: No, sir. I started from scratch. I had almost no capital. I think our capital was about $4,000 when we went into business, 12 years ago now to be exact. At that time we started with a very small location of about 1,000 square feet, and we are now doing a trade of approximately $1 million a year. We have about 25 employees on our books, but only my wife and myself initially started the business in 1962.

The Chairman: What floor space do you have now?

Mr. Gaynor: We have a total of 12,000 square feet.

The Chairman: So you have kept expanding from that initial 1,000 square feet?

Mr. Gaynor: Yes, we kept expanding to this point. I think I may be being premature, but the point I was going to make is that the opportunity to expand has been in large part due to the fact that we withheld any withdrawals and benefits to ourselves for quite a long period of time and utilized the profits of our business to plough back into the organization in the hope of developing a going business.

The Chairman: And the lower rate of tax enabled you do do that.

Mr. Gaynor: It was vital to our growth.

The Chairman: You got more retained earnings.

Mr. Gaynor: It was vital in two aspects. Not only did we have the higher rate of retained earnings in the business to enable us to grow, but we are not a very popular animal vis-à-vis the big banks, we are not a very popular animal vis-à-vis even big businesses in some sense; we are people whose future is very much more in doubt than that of large corporations that have existed for a very long period of time. We have found that it is not easy to obtain credit. Naturally, anything that reduces our cash flow could jeopardize our position even further, and would worsen our condition in all these areas where we are already handicapped considerably compared to large publicity held corporations or businesses with long histories. We find that in these days we have great difficulty in locating our business, in terms of growth, because as the large corporations develop in the shopping centres and so on, the independent man is looked at as of no account and as somebody a little dubious. We are working in a difficult environment. At the same time, I feel that we are essential to the character and nature of the economy; we add some colour. I think we have a sense of excitement.

To take this away from us takes away in two areas, and as an independent businessman I am looking at a double change. I am looking at the loss of my right to grow; and I have no source of credit and there is the reduction in the retention of income. That plus the fact if I succeed despite all the obstacles and do develop the business, I have certainly a great change in the fact that my capital gains are taxable as well. So the opportunities are sharply reduced for men like myself to work eight days a week; there is really not the same incentive. To what extent this will produce a loss to the community I cannot really say, but I know one debates whether one just should not sell and forget it because, after all, there are lots of jobs being offered with much more security, so why take a risk and gamble? What are you achieving? I think of it not as much in terms of money, but you like to feel you can build something and create something. If you cannot create and build it when you are running your own business, dressing your own windows and looking after your own customers, it is not worth bothering with and taking the first step.

The Chairman: I think what you have said does point up the fact that maybe there are conditions in relation to the area in which you operate which should be treated separately from other businesses.

Mr. Gaynor: It is my contention that in the retail industry in general there are thousands and thousands of people in my equivalent situation, and these people sometimes, not on a national level but at the local level, are very valuable citizens to the community and have proved themselves interested in what goes on in the area and have contributed greatly. If they are eliminated we are going to be left with a very sterotype retail structure, and I think

that it would be a great shame and pity if this should happen.

Senator Connolly (Ottawa West): I think what you are saying is that if these incentives are removed it is not going to be worth remaining in the business?

Mr. Gaynor: What happens in a situation like that of myself—and when I speak of myself I am really speaking for people very much like myself—is that we are really in our category called upon to make considerable sacrifices, and some incentive really has to be given us to make these sacrifices worth while. Unlike the lawyers we have just listened to, we are not really offering only a service for a certain return for our service but we like to build a creative and constructive concept and we like to see it carried through and grow.

Senator Connolly (Ottawa West): There are two things which arise from what you have said. One is that uniformity is not necessarily a good thing, even in the business community.

Mr. Gaynor: Yes.

Senator Connolly (Ottawa West): Diversity is good?

Mr. Gaynor: Yes.

Senator Connolly (Ottawa West): And perhaps diversity is not the only element in the smaller business, but perhaps you lead with ideas and methods and help the big business?

Mr. Gaynor: Yes.

Senator Connolly (Ottawa West): The independent young man like yourself has the incentive to do things that perhaps in a bigger organization it might be a little more difficult to achieve because of the fact the younger men are at the lower level of the policy-making process.

Mr. Gaynor: Yes. As far as retailing is concerned, it is very true today and has been extremely so in the last two or three years, with the emergence of different merchandising concepts, particularly with regard to the young people, all the way up the line to the very large department stores. The whole industry has been recently revitalized by the fact that the young people are much more prepared to adopt new fashions.

Senator Connolly (Ottawa West): This is because of the development of more sophistication?

Mr. Gaynor: Yes, the novelty of idea and the willingness to experiment and take chances.

Senator Cook: And that involves a lot of hard work?

Mr. Gaynor: Yes.

Senator Lang: And largely by new Canadians?

Mr. Gaynor: I happen to be one, but I think a lot of others come into this category too.

Senator Connolly (Ottawa West): We talk about the diversity of our people, and you want to see reflected the same kind of diversity in the business community?

Mr. Gaynor: Yes.

Senator Connolly (Ottawa West): The other point I want to ask you is this. You seem to be an optimistic type of fellow and you see the opportunity for the smaller business to grow into a bigger business as a result of this incentive?

Mr. Gaynor: Particularly in retailing, the opportunities for smaller businesses to grow are considerable. There is the novelty of approach, the speed of reaction, adaptability in terms of dealing with people. These seem to be factors that enable small businesses to grow and develop. Unlike the manufacturing industry we do not have great capital expenditures to make and do not have great depreciating assets. Our receivables are spread among a thousand customers, but it is not like receivables which are paper than can be borrowed against with ease. Our inventory is not the same kind of inventory as nuts and bolts; it is rapidly depreciating. If we happen to close our doors for four weeks, the season is over. We do not have receivables and inventory that is really a good credit basis, and we have to create our own Capital from profits, but I think we can offer great variety and excitement.

Senator Connolly (Ottawa West): I think you will agree that in an industrialized society like our own there is room for this kind of enterprise, but at the same time there must and should be opportunities for the larger organization with a bigger business also to cater to requirements which are perhaps less of a specialized nature, which are to satisfy the needs of people perhaps at a lower level of income, perhaps the cheaper quality of goods which your type of business would not supply.

Mr. Gaynor: In anything I have said I am not trying to minimize the competitive situation of the larger business. We are basically not afraid of them; basically we like to be next door to them. In fact, all my three stores are as close as I can get to the bigger ones.

Senator Connolly (Ottawa West): I suppose it works both ways.

Mr. Gaynor: It works very well.

The Chairman: You go where the people are?

Mr. Gaynor: Yes, we go where the people are and where my competition is.

Mr. McKichan: Turning to the situation of personal income tax, we make the point here that because of other recommendations we have made in our submission it may be felt necessary to delay introduction of some of the recommendations of the White Paper, and we suggest some of the proposals made for the amendment of personal income tax are postponable. I think we would not wish to see placed in this category the increase in the general deduction, because we appreciate that this is only keeping the personal income tax system in step with inflation. But some of the other amendments, such as that concerning child care expenses and employment expenses—in respect of the structure of both of which we have suggestions to make—we suggest might well be postponable if it is necessary to postpone some elements of the proposals.

Dealing with the child care expense, we make the point that as the recommendation is framed the new allowance would be of most assistance to relatively high income earners, particularly to the professional woman or some other person in that kind of bracket. Typically in our industry there are a great many part-time married women at work, who may only work three or four hours a day, and who may be relatively unskilled and thus in the lower income levels. Such a person's total gain from her endeavours may not put her into a tax bracket, or it may put her in the lower tax bracket. So, for her the assistance which is proposed in the White Paper would be of no use whatever.

The Chairman: It is meaningless?

Mr. McKichan: Yes, sir. We submit that this is wrong and that, in fact, the entry of married women into the labour force should probably be encouraged because of the demand for their services. Certainly the retail industry would probably break down if it were not for the participation in its labour force of many thousands—perhaps hundreds of thousands—of part-time employees.

The Chairman: How do you suggest you might change this to make it meaningful in relation to married women who are part-time employees?

Mr. McKichan: We suggest that it be made meaningful by allowing it to be deducted from the income of either partner in the marriage.

Senator Connolly (Ottawa West): You are suggesting a kind of community between husband and wife for income purposes?

Mr. McKichan: Yes, sir, related to this deduction for child care expenses.

The Chairman: You propose that either one should be allowed to take the benefit?

Mr. McKichan: Yes, sir.

Senator Isnor: I suppose you are really referring to two of your associates, the larger department stores, which engage a large number of women as part-time employees?

Mr. McKichan: This is as true for them as it is true for the grocery trades which depend very heavily on this type of employee to cope with the heavy volume of business done on Thursdays, Fridays, and Saturdays. Of course, the so-called variety stores also depend largely on this type of help, and here I am referring, for instance, to Mr. Moffat's organization, the S.S. Kresge Company. I think you will find that Mr. Gaynor, as an independent retailer, also employs a considerable number of part-time employees.

Senator Connolly (Ottawa West): The answer to the question I asked, I take it, is that you do not want to see the husband's income grossed to the wife's income. To come back to what you propose it is this, assuming the main breadwinner in the family is the husband, and the wife finds there is a need to supplement the income and so takes on part-time work, she herself, because there are children who incur certain expenses while she is working, should by law be given the privilege of deducting from the income she earns the costs that are incurred to earn that income?

The Chairman: That is not the point. It goes further than that. Their income may not be at a taxable level, and therefore the deduction is meaningless. The question is: Are they entitled to something? It is suggested that to make it meaningful either the husband or the wife should be entitled to the deduction, depending upon which one is in a taxable bracket and thus able to take the benefit.

Senator Connolly (Ottawa West): Yes, that is the further development of it. Conceivably the part-time worker who is a woman might have a taxable income.

The Chairman: If you say that either one may claim it then all aspects are covered.

Senator Connolly (Ottawa West): Yes.

Mr. McKichan: As I suggested, it should be at the option of the taxpayer.

Senator Carter: Are you saying that either parent should be able to take advantage of the whole deduction, or that it should be divided if there are two parents working?

The Chairman: You cannot limit it to one or the other because the husband may have a taxable income and the wife may not.

Senator Carter: It should go to the one who can take advantage of it?

The Chairman: That is right. That is the only way by which you can make it meaningful.

Mr. McKichan: We were not suggesting that you award it twice. We did not suggest that it be deducted by both, but if it can usefully be divided between the two of them then this is something that we would favour.

Senator Lang: Does this proposal now preclude that? In other words, is the deduction permitted only to the spouse with the lower income? Is the spouse with the higher income precluded from using the deduction?

The Chairman: It may end up that way. If the child care expenses are incurred because the mother goes out to work, then perhaps the mother is the one entitled to the deduction. The White Paper is not clear.

Senator Lang: But I am saying that it is not limited to the husband. If his income is higher there is nothing to say that he cannot claim the deduction.

The Chairman: It does not say he can.

Senator Lang: But it does say he cannot.

The Chairman: There are many such things in the White Paper.

Senator Connolly (Ottawa West): I think it is possible for this committee to make a recommendation in the terms mentioned by the chairman, namely, that there should be an option.

Senator Lang: An option so that either spouse can claim the deduction?

Mr. McKichan: This is our proposal, senator.

The Chairman: Section 1.33 reads:

> Costs of looking after young children when both parents are working, or when there is only one parent and that parent is working, would be allowed as a deduction subject to certain conditions. This new plan is intended primarily to benefit mothers who need to work to support their families, and would be in addition to the normal exemption for children. The maximum expenses allowed would be the lower of $500 per child under age 14 or $2,000 per family.

But, it is not clear. It is subject to certain conditions, but what are they? What this organization is saying is that they should make sure that the thing they are providing for—child care expenses—is made in a meaningful way so that either the mother or the father, whichever one is in the taxable bracket, may get the benefit of the deduction. That is all they are saying, and I think it is a good point.

Senator Isnor: It provides an unfair advantage in so far as the smaller retailer is concerned when he is compared with the larger firms who are represented here. They keep open at nights and take on these extra part-time employees, in competition with those firms which have regular experienced staff 24 hours of the day.

The Chairman: It is not one of the White Paper proposals that we regulate the hours during which stores are open, so we are going to stay away from that one, Senator Isnor.

Senator Isnor: I am pointing out the reason why the claim is being made for exemptions for the extra part-time employees. Is that not your point, Mr. McKichan?

Mr. McKichan: No, Mr. Chairman. I think our point is that all retail stores—large stores and small stores—employ large numbers of part-time employees whose total incomes may be small simply because they are working only a few hours a week. However, the extra money they earn is often of great assitance to their families, and is of equal assistance whether the employee works for a large or small employer. That many working mothers are going to be in this low income category is a circumstance that should be recognized in the institution of the child care allowance.

Senator Isnor: Is it not a fact that two of your associates are the prime employers of the so-called extra help?

Mr. McKichan: I think it would be fair to say that a very large percentage of the retail trade is able to operate by reason of part time help, not only part time help in the evening but more particularly between the hours of 11 and 3, which are often the peak shopping hours in downtown stores.

So far as the general deduction for employment expense is concerned, we have taken the position that instead of the blanket exemption there be a provable but more limited exemption. It has been

suggested that to require all employment expenses to be proved would involve a great mass of paper work, and this of course is probably correct. In discussing this immediately prior to our appearance before you, we discussed—although of course we do not have a mandate to put it before you as a formal proposition—the possibility of treating the employment expense in the same bracket as the charitable expense, and giving a relatively small, perhaps no more than the present $100, exemption as a blanket exemption, and making expense greater than this provable on production of receipts. This conceivably could be a happy compromise.

The Chairman: The one proposed is $150 as a maximum, or a percentage if that produces a lesser amount.

Mr. McKichan: We felt this was somewhat of an expensive allowance in relation to the other various deserving needs for exemption or special treatment in the whole tax picture, and we suggested that the emphasis placed on this be reduced.

Mr. Cronkwright: It is expensive to provide the $150 deduction to all employees by this method and at the same time keep the $100 standard deduction, which is to cover charitable and medical expenses. It does not really solve the problem of the employee who incurs substantial costs in earning his employment income. He will be limited to $150 regardless of the amount of actual expense he incurs. We feel that to give every employee the $150 deduction without proving any costs is overly generous, but at the same time it detracts from the person who in fact does have to spend much more than that. Our thought was that if there is to be a standard deduction in any event, such as the $100 for charitable and medical, under which either you take the $100 or if you have spent $105 prove the $105, the employment expense might be taken as part of the same package so the person would have $100 or $150 standard deduction. If he could prove he had in fact spent more than that in his medical, charitable and employment expenses, then he would prove the whole total and take that as a deduction.

The Chairman: Would you proceed.

Mr. McKichan: In relation to other employment expenses and expenses of doing business, it is our feeling first that the White Paper seems to have exaggerated the degree to which there has been abuse of the privilege of deducting expenses of doing business, entertainment and so on. We do not believe the problem is a large one. We believe the discipline of the profit motive is a pretty strong discipline. Our major members have themselves quite strict internal rules about the type of expenditures allowed for travelling and other matters of that nature.

The Chairman: Would you develop that in relation to the businesses you represent at the retail level, the purpose and function of attending conventions and conferences?

Mr. McKichan: Perhaps I might speak first about the type of conference that our own association runs once a year. It is a two-day conference, and 80 per cent to 90 per cent of the time spent at the conference is on instruction and education. We bring in speakers who can talk about new developments in the retail trade, many of whom come from the United States where many of the advances in distribution are being made. Others come from Canadian universities or institutions of that nature. For smaller members particularly the experience is no more than the equivalent of the in-store or in-company meeting of the larger organizations, who may bring their executives in for sessions to present to them the new philosophy of the company or the new techniques they are going to adopt.

The Chairman: You are not concluding that the references to disallowing convention expenses etc. would apply to such meetings?

Mr. McKichan: It seems conceivable. We understand that thought is being given to disallowing seminars. The recommendations are vague, but we are fearful that this may be the case.

The Chairman: Except that you do not have to call them seminars. If you summon your top men from various parts of Canada for the purpose of instructing them on how they should operate, how they should change certain phases of the operation etc., surely that would not fall into being a convention expense. We may be getting into a use of words, a sort of labeling, and maybe you should describe in a factual way exactly what is being done, or proposed to be done.

Mr. McKichan: I think I misunderstood you, Mr. Chairman, and I am sorry. It was not my suggestion that even the White Paper recommendations would strike at a company bringing together its employees for a specific purpose. I was using the analogy of this practice of a large concern with the meeting of independent businessmen who get together for the purposes of self-instruction, which it seems to me they should do and continue. In doing so, they have the equivalent of the type of meeting which the large company can organize within itself.

The Chairman: It would appear that judging from the language in the White Paper it really depends on what you call it. If you call it a convention you are on the spot apparently, they would say.

Senator Phillips (Rigaud): If you drink orange juice it is deductible, but if you take hard drink it is called a convention.

Mr. McKichan: It is a pretty rigid distinction.

Senator Phillips (Rigaud): That seems to be the distinction in the White Paper.

The Chairman: If that were the distinction it would be quite easy to determine whether it was a convention or not.

Senator Phillips (Rigaud): To determine whether it was a convention, your practices would seem to determine the deductibility or otherwise.

Mr. McKichan: I might add this in this vein that it is a characteristic of the retail industry that often buying marts are run coincidentally with something that is labelled a convention, or something else of that nature, but for the retailer it is extremely important to attend to look over new lines and see what is happening in the market, and often to place his orders. Unlike other types of business, where more often the seller may come to the buyer, in retailing there is still a considerable amount of the buyer coming to the seller. Certainly the industry would not like to see this type of expense struck out.

Searching around for an alternative to the treatment of ordinary, everyday entertainment expenses and so on, we were hard put to it to come down on a recommendation more definite than that of its being reasonable in relation to the nature of the business, because every business has different characteristics. The business dealing in the export market has a very different type of test of reasonability from one dealing purely in the domestic market.

Senator Phillips (Rigaud): On the full circle you have the element of reasonableness already in the present statute.

The Chairman: Going on, Mr. McKichan, you are talking about the basic exemption here. I was wondering before you develop that whether you would deal with this. We are all aware that the White Paper proposes to increase the basic exemption from $1,000 to $1,400 for a single person, and from $2,000 to $2,800 for those of married status. I wanted to put a proposition to you.

You realize, of course, that when you find the personal rates of income tax substantially increased under the White Paper proposals this is represented as being necessary because of the increase in the personal exemptions. It is represented that this is necessary in order for approximately 750,000 people to be taken off the tax roll. We have also been told that the tax revenue loss by reason of removing these 750,000 people would be about $35 million. We are also told that the effect of extending those increased exemptions the whole way along on the personal income this would produce a loss of revenue of about $1 billion. If we established a dollar amount for single persons and for people with married status, and we said up to that amount there is no element of taxable income, then we would only be reducing the potential tax revenues by $35 million. If we did nothing with the exemptions from there up and left them where they are, the other loss of tax revenue would not occur, is that not right?

Mr. McKichan: Yes.

The Chairman: I remember a speech Mr. Brown, who is the tax consultant in the Finance Department, made to the Canadian Tax Foundation in Montreal that the main thrust of the White Paper was to relieve these people in this low income bracket from being subject to income tax, and that is why they have set up this scheme to increase exemptions. You can accomplish that without having imposed on yourself the problem of finding almost $1 billion of lost tax revenue. Do you not think it would be a good idea?

Mr. McKichan: If this system were accompanied by appropriate adjustments in other rates of personal tax, perhaps somewhat along the lines we have suggested, this might well appeal to our membership.

The Chairman: You have to assume as part of this package that the present rates in the higher levels would not be increased, is that what you mean?

Senator Phillips: I think the chairman is putting this question to you: Instead of giving increased exemptions which will cost the Revenue $1 billion and forcing the Revenue to go to the higher brackets, from roughly $15,000 onwards, would your association not agree with his idea and hence agree that it is not necessary to increase the rates of taxation against those in the middle income brackets?

Mr. McKichan: I am inclined to think this would find favour.

Senator Phillips (Rigaud): Do you think that would represent the consensus of your association?

Mr. McKichan: Yes, because our members have considerable concern with the middle income groups and their plight after the introduction of this proposal.

Senator Phillips (Rigaud): Therefore, as I see it, our Chairman's formula, with the elimination of the increased exemption bringing about with it the non-necessity of increasing rates against the middle brackets, appeals to you?

Mr. McKichan: Yes.

Senator Connolly (Ottawa West): I think that a group of this character who suggest their taxes should be lowered and that . . .

The Chairman: There has been no suggestion in what I have put to these men of a lowering in taxes below the present rates. All I have said is that you draw a line in dollars for single and married people and you say that if you do not go above that level there is no element of taxable income. You forget about exemptions, and then you go along with the rest of the rates exactly as they are.

Senator Connolly (Ottawa West): And you have a short fall of $35 million.

The Chairman: And you have a short fall of $35 million, and it is a lot easier to find $35 million than to find $1 billion.

Senator Connolly (Ottawa West): $35 million must be found, and I do not think anyone would want to say that $35 million should be found in the lower strata of income earners.

The Chairman: It would not have to be found in the personal earnings at all; there are other areas that they are proposing to produce more income tax from.

Senator Phillips (Rigaud): You have a projection of $600 million in excess of the current rates at the end of the fifth year. That could easily absorb the loss of $35 million with respect to those taken off the tax roll.

Mr. McKichan: Mr. Chairman, under our heading "Reduction of maximum rates" on page 8 it is our suggestion that the level at which the maximum rates be applied is set relatively low in the White Paper proposals, keeping in view the need to continue to provide incentive to this type of taxpayer who is liable to be the most creative and the most innovative and to add a great deal to the economy.

It is our suggestion that the highest rate of tax should not apply until some considerably increased figure, and we suggest $50,000, for the sake of argument. Of course, this implies that there would be a graduation of rates up to the maximum figure. Of course, we are prepared to countenance that.

The Chairman: If the proposition I put to you were recommended and accepted, this problem disappears?

Mr. McKichan: Yes, indeed. We suggest there should be a larger element of progression in the tax incentive.

Turning to the inclusion of gains in ordinary income . . .

Senator Lang: Am I correct in my recollection that the Carter Report recommended that the maximum rate come in at $100,000?

Mr. Moffat: That is correct.

The Chairman: I think so.

Mr. McKichan: We felt $24,000 was much too low.

Dealing with the inclusion of gains in ordinary income, this was not a proposal we greeted with any warmth, but I think we prefer to say that we have taken it as more or less inevitable, given the climate in the nation at the time.

The Chairman: Do you mean you are opposed, but if it must be, then you have some suggestions?

Mr. McKichan: Yes.

The Chairman: Then let us have them.

Mr. McKichan: The basis of our suggestion is that the rate of tax bears some relationship to the duration of time during which the asset is held. In other words, the maximum rate be applied against gains realized in the early period in which the asset has been held and some taper be applied to the rate at a later date . . .

The Chairman: I have been calling it areas of transaction which are described as "making a fast buck." You say the full income tax rate should apply there?

Mr. McKichan: Yes.

The Chairman: And as the period of holding goes along, the rate should decrease?

Mr. McKichan: Yes. We say:

> This system both catches the purely fortuitous or speculative gain and gives some, albeit imperfect, relief to the more usual longer term and, at least partially, inflationary gain.

Senator Phillips (Rigaud): Assume we have a capital gains tax, and if you had the choice, and accepting your concept of time being related to the rate of tax, would you prefer it to be included in ordinary income, in the manner contemplated by the White Paper, or dealt with on a special basis, as is done in the United States, on an ultimate flat rate?

Mr. McKichan: I think we prefer to see it dealt with on a special basis.

Senator Phillips (Rigaud): You would prefer to see it dealt with on a special basis rather than including it in ordinary income?

Having regard to the time factor?

Mr. McKichan: Yes.

Senator Phillips (Rigaud): Thank you very much.

Mr. McKichan: The five year valuation proposal, which has come in for as much criticism as any other element in the White Paper . . .

The Chairman: I would say it has received relatively more.

Senator Carter: May I ask if your scheme of reduced taxes on capital gains, or reduced rates in proportion to the time the assets are held, would eliminate the necessity for the five year revaluation? You would not need a five year revaluation if that system were adopted, would you?

The Chairman: I do not know what you mean by saying you would not need it.

Senator Carter: There would be no need for it. Every year would be . . .

The Chairman: The White Paper says that the revaluation every five years is needed in order to produce the kind of tax revenues that the White Paper envisages; that they are needed in addition to the capital gain.

Senator Cook: Also, it is for your own good.

The Chairman: Your personal possessions, yes.

Senator Carter: They would be automatically revalued every year.

The Chairman: This is a realized gain. They want the unrealized gains.

Senator Carter: I see.

The Chairman: I do not think you need spend too much time on that one, so far as we are concerned, Mr. McKichan.

Mr. McKichan: We point to the many disadvantages of the five year revaluation.

The Chairman: Yes, and we are glad to see that that is your view.

Mr. McKichan: Turning next, Mr. Chairman, to the concept of income averaging, we take the position that the present system of income averaging seems to constitute a truer form of income averaging than the proposal in the White Paper, which is going to be of no benefit to persons normally earning $18,000 or more per annum. I think it might be of interest to the committee if it were to hear from Mr. Hall, who is concerned with the operation of his company's profit-sharing plan.

The Chairman: Yes. We have heard from others on that, and we would be interested in hearing from you.

Mr. G.E. Hall, Tax Manager, Robert Simpson Company: I will not bore you with figures, but my company has operated a profit-sharing plan for its employees for 51 years. Since 1962 it has been the basic source of retirement income for its employees.

The Chairman: You are referring to the Robert Simpson Company?

Mr. Hall: Yes, and this is a separate plan from that of Simpsons-Sears. They are separate companies.

The Chairman: We have heard from the Mercer Company dealing with five different plans, and I think one of them was that of Simpsons-Sears.

Mr. Hall: Yes, and Simpson's was also represented. As you know from other submissions, the problem under a deferred profit-sharing plan is that the income averaging proposal increases the tax greatly, especially for the lower income employee who is faced now with tax increases to such an extent that in one extreme case the increase is seven times what the tax would be under the present section 36.

The Chairman: Could you give us an example?

Mr. Hall: Unfortunately I do not have figures with me.

The Chairman: Will you undertake to send us a series of figures in which you take particular cases, such as A, B, C and D, and show how the present law works out, and how the averaging proposal in the White Paper works out?

Mr. Hall: Yes.

The Chairman: Would you send that in to us as soon as you can?

Mr. Hall: Yes.

The Chairman: Do you want to add anything more?

Mr. Hall: Not really. I believe that that covers the situation as we see it. It seems to us that the

Government is against persons getting a lump sum on retirement. We quarrel with that. We think the employee should have an option. If the employee feels that his retirement needs are best suited by a lump sum, then he should be able to receive the lump sum. We do not know of any case in which this money has been squandered by the employee. In many cases it has been of great help to him.

The Chairman: The proposal in the White Paper is that you are not entitled to it except in the year in which you get the extra burst of income.

Senator Isnor: That does not apply to your part-time employees, does it?

Mr. Hall: No.

Senator Isnor: How long do they have to be employed before they are able to participate?

Mr. Hall: One year. We have approximately 8,200 members in our profit sharing fund right now, with average assets of about $3,800.

Senator Isnor: That is, across Canada?

Mr. Hall: Yes.

Mr. Cronkwright: I think I might add a comment on that, Mr. Chairman. You mentioned that it is in the year in which you have the burst of income. It must be a third higher than the average of the preceding four years, but it seems to me that the term "averaging" is a misnomer. If you think of the word "averaging" you picture a spreading of something in equal amounts over a period of time. In fact, if you meet the test of having increased your income by a third you do not go back and average, and pick up those important rights that are part of the four-year averaging, nor do you get the low rates that are in that one-third category. All you do is get advantage of the rates that are beyond that average plus a third, so you are getting no advantage within the lower rate structure. It is just not averaging.

The Chairman: Let us assume that the income in 1969 was $10,000, and let us assume that the income by reason of this burst would increase by $5,000, so that in the next year it would be $15,000. How would that work out according to your concept of the averaging in the White Paper?

Mr. Cronkwright: To use the 2-year period I would say your averaging means you have two years at $12,500. Under the White Paper you would base it on $13,333, and you would spread it over the two years and pay the rates applicable on $13,333. In other words, you cannot reach back into those lower rate brackets that you reached in the preceding year. You are pushed into the higher brackets.

The Chairman: It would appear to be designed so as to reduce any benefit available under the existing law and, therefore, produce more income tax.

Senator Phillips: Are we comparing the present law with the proposal in the White Paper?

Mr. Hall: Yes, on income averaging.

Mr. McKichan: Our next section deals with retirement savings plans and here we are in accord with the recommendations of the White Paper. We do throw out the point that there should be some concern about the difficulty in determining the total anticipated benefit to the person who belongs to several registered retirement plans. This may not be regarded as a large problem, and it may be quite acceptable to have persons deriving benefits from more than one registered retirement plan. However, we do not want to make too much of that.

We deal next with the taxing of co-operatives. I know the subject is going to be dealt with, or has already been dealt with, by the Equitable Income Tax Foundation, and I do not wish to duplicate those representations to you. We have endorsed their proposals.

Senator Isnor: Briefly, what is your recommendation?

Mr. McKichan: Our recommendation is that so far as possible, given the different corporate structure of the two types of organization, two organizations with similar profits be obliged to pay similar amounts of income tax. There are, of course, technical difficulties in achieving this, but the matter has considerable significance in retailing, particularly in the Prairie provinces, where there is a heavy concentration of co-operatives, many of them in competition with profit-oriented business. It is our hope that the two will be put completely on all fours. We acknowledge that the White Paper goes some way towards achieving this. We think it should go the whole way.

The Chairman: The next item is the "Nothings".

Mr. McKichan: Perhaps I should defer to one of my colleagues on this.

Mr. D. E. Knechtel, Tax and Insurance Manager, T. Eaton Company: On the category of "Nothings" we feel this provision of a separate class is a good proposal and we endorse it. We make some suggestions as to the type of items that could be included in this category, such as mortmain expenses, discounts on the sale of bonds, finders fees, incorporation expenses and trademarks. At the same time, we would like to see the expenses of issuing or borrowing money covered as they pres-

ently are under the Income Tax Act as an immediate deduction and not have them placed in a category of "Nothings".

Senator Phillips (Rigaud): I would think that the general acceptance of "Nothings" in reading the White Paper relates itself to capital assets so-called, with a special schedule created therefor, and certain types of expenses should be deductible but really do not come under the heading of "Nothings", although I think your reference to it is quite in order and forms part properly of your record.

Mr. Knechtel: It is more of a caution.

Senator Phillips (Rigaud): In order to simplify the situation I think we should accept the conception of "Nothings", as we have done in prior briefs, as covering capital assets which will be dealth with in a separate class from the point of view of amortization.

The Chairman: Accepted on the basis that it means to include capital assets in respect of which at the present time there is no right to amortization.

Senator Phillips (Rigaud): Yes. I only refer to the fact that under the heading of "Nothings" this very able and exhaustive brief covers what should be deductible expenses under, say, the present sections 11 and 12 of the Income Tax Act rather than under the schedule of amortization.

The Chairman: It should be a straight deduction instead of amortization, yes.

Mr. Knechtel: Another point we mention is the treatment of good will. I understand there is not too much certainty about how some of the proposals will come out. I understand that in the first year good will will be subject to 40 per cent tax, and the Government proposal considers that if you have good will it will increase by at least 40 per cent as a result of being a deductible item. But from there on a further 5 per cent will be included in income over the years until you get up to over 100 per cent. This additional 5 per cent will really mean that if your good will does not increase and you take that initial 40 per cent as really the increase in value resulting from the implementation of the White Paper, you are having a retroactive taxation on prior good will as a result of bringing on this 5 per cent each year to bring it up to 100 per cent. This does not seem quite right. I do not know whether anyone has anything to add to that.

Mr. Cronkwright: This is a proposal that does not get a lot of discussion in the White Paper, and as we get more and more information about the apparent intention we get more and more concerned that in fact there will be retroactive taxation. I think clearly you have to divorce the initial 40 per cent included in income and take that as one step. The intention there, as Mr. Knechtel said, is to tax away the apparent increase in value which would arise as a result of the good will becoming deductible in relation to the purchaser.

I think the assumption that there will be an increase is a valid one. Whether it will work out in exact numbers is perhaps debatable. That seems to be one proposal. The further proposal that in year two 45 per cent of the proceeds should be taxed, and in year three 50 per cent, on the grounds that what is then being sold is partly new good will and partly old good will, again may be correct. If what you are getting for your good will has not really changed in amount, then to the extent that you tax newly created good will the old good will has disappeared, and there is just no proposal in the White Paper to accomplish that.

Let me try to clarify it with a couple of numbers. Take a small business where the proprietor decides that at the start of a new system his good will is worth $100,000. If he sells in the first year, say for $125,000, the purchaser being prepared to pay that higher amount because he is buying an appreciable asset, after tax he will net his $100,000, so he comes out where he should be. However, if he waits till year two to sell and he can still only get $125,000, then he pays tax on 45 per cent of the proceeds. In year three it is 50 per cent of the proceeds. I just do not accept this argument that you can tax increasing amounts of the proceeds because it is new good will unless at the same time you say the old good will which has disappeared is in fact an incurred loss.

Take the example of a business where the good will goes from $100,000 to $125,000 in year one; the owner waits till year five, the business suffers a real setback because of new fashions, designs or something of that nature, so the owner is only able to sell his good will for, say $10,000–in other words, it has clearly fallen from $100,000 to $10,000–not only does he not get a loss deduction for his $90,000 loss, but he will have to pay tax on 50 per cent of the proceeds, of the $10,000. I just do not see the rationale of that.

The Chairman: The section, which is paragraph 5.8, deals only with the situation from the effective date of the implementation of the White Paper proposals.

Mr. Cronkwright: That is correct.

The Chairman: It relates to a sale of a business, including the good will from that date on.

Mr. Cronkwright: That is right, but you will not be entitled to establish any value for your existing good will.

The Chairman: That is right.

Mr. Cronkwright: If it were land you could say the land is worth $100,000, and if I sell it for $100,000 I do not pay any tax. If you say the good will is worth $100,000 and you sell it for $100,000 you will have to pay tax on at least 40 per cent, and if you wait long enough you will pay tax on 400 per cent.

The Chairman: Is it not a fact that the problem of good will will arise only if there is an element in the sale agreement that deals with good will? I do not think the White Paper proposes that you will assume in any sale of a business after the White Paper proposals are implemented, if you simply make an agreement selling the business for so much money, that the department would allocate a portion of that price to good will.

Mr. Cronkwright: I would not think there is any question at all that that price would be allocated amongst the component assets, and if one of those you have sold is good will you will face a tax.

The Chairman: If that is the meaning—and it is not clear from the White Paper—it becomes very important that you do an allocation of the various elements that enter into the make-up of the price, including an allocation as to good will.

Mr. Cronkwright: That is right, which of course is always subject to review by the taxation division and by the courts.

Mr. Knechtel: The purchaser would certainly want to see an allocation of good will in order that he can get his 10 per cent depreciation.

The Chairman: He certainly would. So you can be sure it will be in there.

Mr. McKichan: Mr. Chairman, I now move to one of the kernel aspects, the treatment of closely-held corporations. You have already heard some of the principles behind our thinking on this subject from Mr. Gaynor. We are not, of course, arguing for the perpetuation of the existing treatment on the ground of equity. We are arguing on the ground it is a useful and necessary incentive to small business, it allows small business to grow and eventually become large business.

The arguments have been made that only incorporated and not unincorporated businesses can benefit and that professional people cannot benefit from it. For these reasons there is a considerable element of inequity. We have taken the position that a successful, small unincorporated business will very soon become an incorporated business and so, in the fullness of time, will be able to take advantage of this.

The Chairman: It seems to me to be an artificial classification, closely- and widely-held. Do you favour that sort of approach?

Mr. McKichan: We have dealt with it on the basis of the treatment of the first $35,000 of income because of the income size.

The Chairman: On the income size, as far as small business was concerned, they would have the choice, under the White Paper, of electing, if all the members of a small business agreed, to be treated as a partnership.

Mr. McKichan: Yes, we looked at this situation quite closely, and we concluded that in many circumstances it would not in fact be possible for the shareholders to take advantage of this option.

The Chairman: They would have the other option where they would get on any money they would take out full credit for the corporate tax paid.

Mr. McKichan: This is true, but our feeling was that for the growth of the business it is important the money be kept in the business and, indeed, encouragement be given for money to be left in the business for his growth.

Senator Phillips (Rigaud): I am anxious to get an answer to this question. Under you item 13 you say that you made a survey and the survey indicates:

> that a significant number of our independent members who are private companies would suffer very difficult problems in financing their continued growth and modernization of their business if the Government decided to implement this proposal.

Would you indicate to me the number of people you contacted and the number of replies you received?

Mr. McKichan: We have approximately 210 companies in our membership who would be classified within this category of small business, and received replies from something over 60 per cent of them.

Senator Phillips (Rigaud): Into what categories did the 60 per cent fall of dissent or consent to the White Paper approach?

Mr. McKichan: There were no consents.

Senator Phillips (Rigaud): No consents?

Mr. McKichan: No, but they all expressed varying degrees of dissatisfaction with the proposal.

The Chairman: That would appear to be a good time to interject the proposal I have been looking

for some support for. I asked Mr. Gaynor earlier as to whether the conditions and problems of small business were such that they should be in a separate category. I was then laying the ground work for this question. If you put them in a separate category and defined a small business as being a business that had a net income of not more than $100,000, and then you said that in respect of those businesses the first $35,000 would be subject only to a 21 per cent tax, and the difference between the $35,000 and the $100,000 would be subject to the full corporate rate, at least each year they have retained earnings of over $10,000 and that sort of retention should generate two or three times that amount in credit.

Mr. Gaynor: $100,000, especially as to the retail industry, is quite a large business, and it is fairly firmly established.

The Chairman: By extending the 21 per cent rate on the first $35,000 to businesses up to a net income of $100,000, do you think the $100,000 is making it too high or should it be $75,000?

Mr. Gaynor: I do not really have a firm opinion on that. I only say there is some merit in crediting it downwards as it reaches towards the $100,000, eliminating downwards. I am saying this is a fairly large business in retailing.

The Chairman: Maybe the $100,000 is too high and maybe it should be $75,000 or $60,000. Are there any other opinions? Mr. Knechtel?

Mr. Knechtel: Well, speaking as a small businessman!

The Chairman: I am sorry. I withdraw the question.

Mr. Knechtel: This type of thing I think would be acceptable.

Senator Phillips (Rigaud): Some of us feel there is merit to the point that the larger corporation that makes a larger sum of money should be entitled to the lower rates. On the other hand, we think it is very important—I am not speaking for my colleagues, but for myself and others—some of us feel it is very important that we work out a formula which will protect the smaller companies and give them the right to build up capital so as to become bigger and bigger, because we recognize them to be the hard core of incentive in this area of retail activity of small business.

Seeing we are facing people so closely connected with the retail industry in this country, I would be most anxious to know what formula you feel would be most reasonable to apply to encourage small businesses. Should it be one that is just "X" amount of sales in a given year or not more than "Y" amount of profit, or a combination of both? What should be a small business?—so that after having decided we might recommend, say, a lower rate of taxation. However, firstly, I think it is very important that we get from the business world what the business world thinks a small business is.

Mr. McKichan: I think, in the first instance, if we had to make an election, we would opt for the basis of net income as against sales, because in the retail trade the ratio of sales to assets is very different from the manufacturing trade, where you are dealing with a one-to-one ratio.

Senator Burchill: That is the present basis, is it not, net income?

The Chairman: No.

Mr. McKichan: In effect, it works in relation to income.

The Chairman: Just income.

Senator Connolly (Ottawa West): Gross income?

Senator Phillips (Rigaud): Is it approved by your colleagues, the test should be of profits rather than sales?

Mr. McKichan: Yes. The ratio of sales to assets in retailing is of the order of 2.31 to 1, as opposed to the manufacturing ratio of 1 to 1, so it becomes unfair to retailing to tie in on the sales basis.

The Chairman: Have you any idea to put forward as to what amount should be stated in the definition of small business, if you wanted to define that category on the basis of net income?

Mr. McKichan: It is a difficult question to answer because when preparing our submission we canvassed many ideas on substitute plans for the present one. A great many plans seemed to have some merit. We always ran up against some drawback which detracted from the new, suggested plan. We were left with what perhaps appears to be not a very imaginative position of saying we are stuck with what we have. We did this only because we could not think of a better, but we did not by any means close our eyes to the fact that there could be a better. It would be difficult for us without the mandate of our Association to suggest any particular level or limit to this.

Senator Phillips (Rigaud): On page 15 you end up with a conclusion that leaves well enough alone, that

it is reasonably subtle the way we have it now. There are those on this committee who have other views and who feel that companies who earn substantial sums of money should not be entitled to a lower rate at all. We are particularly anxious to think of a formula that relates itself to the small business. That is why I am pressing that point, because I belong to that category. It does not make much sense to give Simpson's, Eaton's, Steinberg's, Dominion Stores and all the big stores a low rate in respect to the first part of their profits. I think it is irrational, but I think it is absolutely vital that we try low rates to small businesses.

Senator Lang: If your proposal were implemented, would a small businessman not merely control his net income so that he stayed under the $100,000 figure through withdrawing it by way of salary, or some other method, then ploughing it back into the business by lending it back? He could artificially control his figure to avoid losing the low rate.

The Chairman: On the first $35,000.

Senator Isnor: Not if he had any ambition or enterprise.

Senator Lang: He would maintain the low rate to accumulate $10,000 inside the company and take out the excess by way of salary or bonus.

The Chairman: Then he is increasing his personal tax.

Senator Lang: That is right. He could still keep balancing it to maintain the lowest tax level.

The Chairman: I am not wedded to $100,000 as being the net income base for the definition of a very small business. I am suggesting this to these men and inviting them to tell us what amount they think is right. They say that is the basis on which you should measure a small business. If they think $100,000 is too high, what figure would they suggest?

Mr. McKichan: Speaking as an individual, the proposal you make has a great deal of merit and something of this nature would be well accepted by our membership. Our large members are not anxious to retain the small amount of relief, which is really negligible to them.

Senator Phillips (Rigaud): That is exactly my point. To me it is a pittance and the bigger corporations are not interested in having it.

The Chairman: Mr. Gaynor, if $100,000 is too high, what figure would you suggest?

Mr. Gaynor: My personal reaction facing the problem of an incentive to my own business is the fact that my attitude towards a depreciating allowance would be quite keen. If I could see my business progressing slowly towards $100,000, when I reached that particular point I would live with the statute more comfortably. My suggestion, from my own reaction would be that when the net profit progresses over $35,000 some of my small business status would be taken away from the bottom part so that my progressive tax becomes bigger and less acceptable until I reach $100,000.

The Chairman: You would be increasing the administrative problems.

Mr. Cronkwright: This type of formula is really a continuation of the transition proposals in the White Paper. What might be done, for example, is to give the full $35,000 to a taxpayer at that level and take away $1 for each $2 of profit above that. Therefore, if you are at $105,000 you totally lose the lower rate and it is somewhere in between. I think this also reduces your problem of the salary situation.

Senator Phillips (Rigaud): Could I get a few of these gentlemen's reactions to the following, because we also considered the graduated rates up to $100,000 in profits.

Suppose we divided this small businesses earning up to $100,000 into three groups: (a) profits up to $35,000; (b) profits between $35,000 and $65,000; and (c) profits from $65,000 to $100,000. Could we get a suggestion as to what rights you would regard as fair and equitable in respect of profits from $35,000 to $65,000, and then from $65,000 to $100,000? that your profits are 99, 1,000 and all the rest of it. They are the tax avoidance and the tax immunization aspect of our law which I think would apply the necessary correctives and we are assuming complete integrity in computation of profits and not deal with corrective sections the administration could impose.

Senator Lang: There is no corrective sections to preclude a prior increase in salary.

Senator Phillips (Rigaud): Yes, there is in a corporation. If the corporation is an entity in law and the controlling interest shareholder imposes a salary on the corporation in excess of the value of service he renders it.

There is a present section in the Income Tax Act which would authorize the Minister of National Revenue to reduce that salary having regard to the worth of the services rendered to the corporation. In any event, I would like to get an expression of opinion on rates from 35 to 65 and rates from 65 to 100,000 on the reasonable concensus.

The Chairman: That would appear to divide about 50-50. If you made in the area beween 35 and 65 you would increase the rate to 36 per cent and then the next step up—I am wondering whether going up to 100 is going too high. The 50 per cent should come in before that. I am concerned about what Mr. Gaynor says that $100,000 net income is maybe too high.

Senator Phillips (Rigaud): If you define small business, dealing with 75,000 it becomes easier to deal with the problem.

Senator Connolly (Ottawa West): What is the definition, Mr. Chairman, of small business in the Small Business Loans Act? Is it a $100,000 net figure?

Mr. Gaynor: I believe volume has to be under $250,000 and this is the definition there.

Senator Connolly (Ottawa West): Is there anything below that?

Mr. Gaynor: That is the small business.

The Chairman: What would the net profit picture likely be if your sales volume were $250,000. I don't mean you personally?

Mr. Gaynor: The net would be four or five per cent. If we are talking of somewhere in the neighborhood of $10,000 or $15,000, it would mean a sales volume of $250,000.

The Chairman: On that basis, then, to define a small business as one having a net income of not more than $100,000 is setting it pretty high?

Mr. Gaynor: Yes, sir, you are getting into a pretty high volume operation.

The Chairman: Yes. It would appear that the limit you might expect would be $75,000, or perhaps $60,000.

Mr. McKichan: Perhaps I might suggest that one criterion that might be looked at is the net income level at which a company has a reasonable expectation of going public and getting support for its shares on the market, because one of the strong arguments in favour of special treatment is the fact that this is the method by which small business can get its capital for expansion when it is denied access to the market. Perhaps the underwriting community can give you some useful guidance as to the type of level that should be looked at.

Senator Phillips (Rigaud): Is it as a result of this discussion that we have some material to guide us in deciding what is a small business?

The Chairman: Yes. The last item is integration.

Mr. McKichan: Mr. Chairman, we here made the point that the proposals do indeed seem to have some theoretical justification. However, our committee was, as others have been, bemused by the number of problems the suggestion presents. Perhaps I might ask Mr. Cronkwright to touch on our thinking here.

Mr. Cronkwright: Under the present system we have a form of integration in the 20 per cent dividend tax credit. The White Paper proposes that this be disbanded in favour of an integration that would cause identification of the corporate tax by way of dividends paid by the corporation, and carried out to the shareholders in the grossing up of their dividends, and taking a credit for that corporate tax paid.

We have real reservations as to whether this really accomplishes enough to offset all the problems it creates. We see considerable administrative problems in dealing with the creditable tax within the company. There is the fact that it would be necessary to advise shareholders of the amount of creditable tax passed to them with each dividend payment, and so on.

There are two main criticisms. The first is that it provides varying degrees of relief to shareholders in different circumstances. The main disparity would be with shareholders at the 80 per cent level, and the White Paper would solve this by reducing the top rate of personal tax to 50 per cent.

It seems to me that if you want to carry that further and give a fairer benefit to shareholders of all income levels you might keep the dividend tax credit with its simplicity, but perhaps graduate it. If 20 per cent is the average, then you could have 15 per cent, 20 per cent, and 25 per cent, which would be used by the shareholder inversely as his income rose.

Senator Phillips (Rigaud): We do not find that paragraph very helpful. I am wondering whether you disagreed with each other, and turned up with a nothing here. I did not extract either concurrence or dissent with this proposal.

The Chairman: Mr. Cronkwright has really gone along parallel lines. He finds more comfort, I would say, in the tax credit than in the discount.

Senator Phillips (Rigaud): My observation is made for the purpose of eliciting an indication as to whether on balance you are in favour of the proposed integration, or otherwise.

The Chairman: Of course, we cannot compel them to make an answer. I regard what has been said so far as being equivocal. Do you want to move out of that category?

Mr. McKichan: I think the weight of our viewpoint was against rather than for the integration proposal.

The Chairman: Against?

Mr. McKichan: Yes.

The Chairman: Then that would appear to deal with your representations. Unless you have something more to add I will say that I think you have given it a pretty good shake, and we thank you very much for coming here today.

Mr. McKichan: And we thank you, Mr. Chairman and honourable senators, for your kind consideration and attention.

The Chairman: Honourable senators, before adjourning I should like the agreement of the committee on two points. Is it agreed that the McLaughlin, May, Soward, Morden and Bales brief on the accrual problem be appended to our proceedings today?

Hon. Senators: Agreed.

The Chairman: You will recall also that the Labatt Company had presented a brief and we had fixed a date to hear them, but then they withdrew their brief. They have now amended their brief. They have decided that they do not wish to appear, but they have asked if their brief may be included in our proceedings. I would suggest that we append it to the proceedings of today, if that is in order.

Hon. Senators: Agreed.

The Chairman: Then the committee adjourns.

The committee adjourned.

APPENDIX A

Summary of Submission to the Standing Senate Committee on Banking, Trade and Commerce

by The Law Society of Upper Canada

Regarding the Proposals in the Government White Paper in the Matter of Accounting for Lawyers' Professional Income

The Law Society's submission is presented on behalf of the practising lawyers in Ontario and expresses the interests of lawyers generally across Canada. The brief was prepared after soliciting expressions of opinion from the profession in Ontario. The overwhelming response was one of strong opposition to the White Paper proposal that the accrual method should be imposed in determining legal income.

The historic practice of the profession has been to prepare accounts and submit income tax returns on the cash basis. Since 1948 the cash basis has been an approved statutory method. There are a number of reasons for submitting that lawyers should be allowed to continue on this basis in preparing their income statements. The proposal in the White Paper that legal income should be computed on the accrual basis rests on the assumption that lawyers have an inventory of unbilled time which can be valued and brought into income for tax purposes at the end of each year. This assumption is strenuously challenged on the ground that it is not only factually incorrect but, if adopted, would impose a very severe financial burden on lawyers generally and particularly on the young practitioner at the commencement of his practice.

The brief also draws attention to the point that the practice of law is not comparable to a commercial or manufacturing operation. A lawyer's accounts when rendered do not give rise to an asset similar to accounts receivable and are not available for obtaining credit.

The nub of the submission is that the practice of law does not give rise to day-to-day income which can be accrued and valued as a basis for the imposition of tax.

Submission to the Standing Senate Committee
on Banking, Trade and Commerce

by The Law Society of Upper Canada

Regarding the Proposals in the Government White Paper in the Matter of Accounting for Lawyers' Professional Income

The Law Society of Upper Canada speaking on behalf of some 5500 lawyers engaged in the private practice of law in Ontario is strongly opposed to the proposal in Paragraph 5.46 of the Government's White Paper containing Proposals for Tax Reform that lawyers be required to use the accrual basis in determining the income from their professional activities. The Law Society is a statutory body and it is required by the relevant statutes of the Province of Ontario that all lawyers, whether engaged in the private practice of law or otherwise, must be members of the Society. There are presently some 7,000 members of the Society, of whom 5500 more or less are engaged in the private practice of law. The affairs of the Society are administered by an elected body of lawyers known as the Benchers, under the direction of a senior officer known as the Treasurer. The elected Benchers come from all parts of the Province and represent all types of legal practice. The Benchers also include a number of senior lawyers who, by reason of long service, have become life members. The Attorneys General of Canada and Ontario are also Benchers. Through such contacts as the Annual Meetings of its members and meetings with officers of County and District Law Associations, the Benchers seek to maintain a close understanding of the attitudes and opinions of the lawyers in Ontario.

In preparation for the drafting of this submission, which in its present form has been considered and approved by the Benchers at a meeting held on February 20th, 1970, notice was given to the lawyers of Ontario through the Ontario Reports, a weekly publication mailed personally to

all members of the Society, asking for expressions of opinion on the White Paper proposal. A large number of carefully prepared written replies was received from all parts of the Province and are available for perusal by the Committee if this should be so desired. The attitude of the lawyers of the Province as expressed in this material is unanimous and determined opposition to the proposal in Paragraph 5.46. There is no doubt that this is the attitude of the profession at large, and the effort in this brief is to summarize the reasons advanced in support of this position.

Position of the Legal Profession in Ontario

The first comment that may be made is to say that, with all due respect to the good faith of those who drafted the White Paper, it is somewhat misleading to say "Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis". Until the 1948 Income Tax Act came into force, it was the general rule as laid down by the President of the Exchequer Court that the cash method of determining income was the basis required to be used under the income tax legislation as it was prior to that time. The 1948 Act made specific provision for the use of the accrual method and, by a series of decisions in tax appeal cases, the Minister of National Revenue established that this method should generally be employed by businesses engaged in trade and manufacturing. Over the period of time that these cases were decided, other judicial decisions made it clear that there were variations of income determining methods and that the full accrual technique devised by accountants was not necessarily suited to all forms of income earning activity. It is the basic proposition in this submission that accrual accounting is not suited to the determination of income from the practice of law, and that by taking this position the Law Society is not seeking to

obtain for its members "an unwarranted advantage by comparison with the rest of Canadians". The Society rejects the implication in this quotation from Paragraph 5.46, which admittedly may have been unintended, that any deviation from the official proposal would have some aspect of impropriety.

The Society also considers that it is not correct to say that "an exception to the general rule has for many years been made for taxpayers in the professions". The general rule for the first 30 years of income tax in Canada was that the so-called cash method was not only an acceptable method but was the technique that conformed to the statute as it then was. As already mentioned, in 1948 the statute opened the way to the requirement that business taxpayers at least adopt accrual accounting but the statutory recognition of cash accounting for the professions simply confirmed established practice and did not create an exception.

The Society does not accept the assumption in Paragraph 5.46 of the White Paper that lawyers are in "business" in the same way in all respects as are merchants and others engaged in commercial and industrial activities. This position is taken with no thought of drawing invidious distinctions between one income earning activity and another but to give expression to basic differences. These differences have historic roots, but the limitations under which the lawyers function in carrying on their practices are directed essentially to the protection of the public. These differences and limitations may be summarized as follows:

(1) The lawyer cannot advertise his services or solicit business.

(2) Communications between the lawyer and his client are privileged against enquiry from any authority.

(3) The practice of law cannot be carried on through

or by a corporation. The lawyer as a consequence is unable to enjoy the special advantages of incorporation such as a low tax rate and favourable pension arrangements.

(4) The lawyer has unlimited personal liability for his negligence and defaults.

(5) A lawyer's fees are not ordinarily based on contract and in any case are subject to taxation (being a review to determine whether the account is for a proper amount) by a court official. An "inventory" of goods has been acquired or produced by the expenditure of money already earned and received by the taxpayer. Such an inventory is referred to in Paragraph 5.48 of the White Paper. The lawyer's unpaid accounts and unbilled time can in no way be considered as an "inventory" as he has never received payment and at best is an asset which cannot be sold or disposed of. The point is of importance in another context dealt with below.

(6) Contrary to the impression conveyed in the White Paper proposal, the lawyer does not have an " 'inventory' of unbilled time" which is in any way comparable to the inventory of goods for sale or in process of manufacture owned by a merchant or industrialist. The suggestion in the proposal that lawyers reporting on the cash basis "omit" something that has commercial value comparable to an inventory of goods is, with respect, misleading. This point is developed at greater length in later paragraphs of this submission.

(7) The statement that a lawyer enjoys a "tax postponement permitted by this (cash method) concession" rests on the assumption that the lawyer

earns something when he spends time on his client's affairs which is comparable to what the merchant earns when he sells goods from his shelves. The merchant's goods are, however, tangible saleable property usually carrying an objective profit potential.

(8) A taxpayer, as in the case of service businesses such as those of a commercial salesman, earns a fixed contractual reward. The lawyer earns his living by applying his time and capacities on his clients' affairs, but the fee that may eventually be received is affected by many diverse factors. It is a misconception of a lawyer's operations to regard them as giving rise to an hourly or daily profit or even an entitlement to any profit which, unless taxed currently in accordance with some accrual technique, will result in tax postponement.

Position of the White Paper on Professional Income

The approach to the tax of lawyers' incomes taken in Paragraph 5.46 of the White Paper indicates that the Minister had two particular matters in mind, namely:

(1) the time a lawyer has spent on his client's affairs, described as unbilled time; and

(2) the amounts "due" from clients on the basis of accounts rendered to the client.

A third somewhat in-between element in the proposal as publicly stated by government officials is the alleged deliberate postponement of the realization of income by deferring the rendering of accounts for completed work for undue periods of time, thereby bringing the income when received into a subsequent taxation year. This is really no more than a rough and unofficial attempt by some professional men to achieve an "averaging" of their

incomes as suggested in Paragraphs 2.55 and 2.56 of the White Paper, since no other beneficial result could come from such a practice. Any lawyer who followed this practice would necessarily defer the enjoyment of the portion of his income remaining after taxes until he actually had sent out his accounts and received payment for them. It is considered that further comment on the matters referred to above will be helpful to the Committee.

The Lawyer's Interest in Unbilled Time

With regard to the alleged profit element in unbilled time, it is most important to understand that the practice of law is not conducted in any over-all uniform way. There is a wide variety of law practices and of methods of obtaining payment for services rendered to clients. Without purporting to give an exhaustive outline, the following types of activity can be noted. It is emphasized that these are types of practice, and within one firm and even in the range of the activities of one lawyer several types may be combined:

(1) The lawyer in criminal practice who adopts the practice of receiving his fee in advance of rendering service is on the cash basis whatever accounting method nominally may be followed.

(2) There is no pattern of fees for the lawyer engaged in litigation. Many clients, whether the plaintiff or defendant, can pay only modest amounts in the first instance, and the lawyer's reward and profit will not be determined until the case is concluded. Litigation is necessarily a deliberate process and very frequently extends from one year into another. These comments are relevant generally to all forms of adversary activity, including municipal and labour negotiations.

(3) In the field of estate and trust administration

certain fees are subject to a tariff which affords some indication of what may be received in the future. Many estates, however, require years of service and the fees are fixed intermittently and then by judicial order or by agreement. In no instance does the lawyer become entitled to any fees during the course of the work. His entitlement is the result of agreement with the client or a court order.

(4) In the field of real estate some aspects of the lawyer's work are subject to tariffs of fees, but settlement and payment of the fee in all cases is deferred until the transaction is closed.

(5) The business or corporation practice. Of all types this may conform more closely to the conception of a law practice that appears to be held by the draftsmen of the White Paper. There is a continuity of association between the lawyer and the client over a period of years. The client expects regular accounts rendered at least annually, or even more frequently, and the lawyer tends to render his account with considerable regard for the time spent on the client's affairs. It is only in the very exceptional case of the large firm that can afford the overhead of the requisite bookkeeping and accounting staff that records are kept which have any analogy to an inventory of unbilled time.

Except to a limited extent in the case of the practice of a business or corporation lawyer, it is not feasible in the great majority of instances to forecast at a year end with any degree of certainty whatever what the eventual fee will be when unfinished work at that time is completed at some future date. It is, moreover, impossible

on any basis that would have general application to lay down rules which would establish what part of the final fee, if it can be estimated, had been earned at the year end. The idea that a lawyer earns his fees from day to day is not only legally incorrect but factually untenable. In a very real sense the lawyer earns his fee only when the work is completed to the satisfaction of the client, and the amount received is then subject to agreement or taxation.

A further very important point is that an ever-increasing amount of legal work must wait on departments of government for payment. In this category we find not only work done directly for departments of federal and provincial governments, but claims under The Motor Vehicles Accident Claims Act, work undertaken under Legal Aid, and similar items. In such instances, not only is there no possibility of collecting any portion of the fee in advance or during the course of the work, but there is usually a fairly lengthy delay after completion of the work, and rendering of the account, while the account is being processed and in some instances taxed.

The Society feels very strongly that the concept that the lawyers have inventories of unbilled time in respect of unfinished work at the end of a fiscal year which can be valued and included as income simply does not reflect the actualities of legal practice in Ontario and in Canada. The Society also feels that it should point out that if by some general statutory or regulatory direction "(lawyers were) required to use the accrual basis", to quote the proposal, it would be found by the Department of National Revenue that there is no generally accepted and workable "accrual basis" that could be applied to even a significant fraction of the lawyers in practice. The consequence could very well be frustration and ill will on both sides with no real benefit to the Revenue by way of acceleration of tax collection. Moreover any attempt to

require keeping the detailed records necessary for an effective accrual system would cause a substantial increase in accounting staff and in fees necessarily charged to clients in most offices.

A further consequence of imposing the accrual method would be that in many cases a young lawyer starting his own practice, after seven or eight years of higher education and with sizeable outstanding financial obligations resulting therefrom, might find that during the first two or three years or more of building up his practice and his outstanding accounts, he would have had no income whatever for his own living expenses after paying office expenses and income taxes on his so-called "inventory of unbilled time". This could well prohibit all but a very small percentage of newly graduated lawyers from starting their own practices.

Accrual of Finished Work

The foregoing comments lead to the suggestion that the accrual basis should be applied to the extent of giving the Minister some authority or discretion to require a lawyer to bring into his income for the year some amount which, in the opinion of an Assessor, was thought to have been earned for finished work but had deliberately not been billed to the client. The Society is unable to say from its own knowledge to what extent this practice is prevalent and whether it constitutes a serious postponement of tax payable on the cash basis in relation to the total income reported and the tax paid by lawyers. The Society suggests that the pressures on the lawyer to collect his fees to pay the taxes he must pay in any event is adequate protection to the Revenue against any serious prejudice in this regard. Moreover, the policing function that would be imposed on the Minister's officials would require time and effort that would not be justified by the results achieved. It is very often difficult to know

when a lawyer's work is finally completed in order that a bill should be sent. The problems in this regard are closely analogous to those that faced the Department in exercising the powers the Minister at one time had under Section 13 of the Income War Tax Act, which was dropped in 1948, to require redundant surplus to be brought into income and taxed. There are somewhat similar rules still in effect in the United States and in the United Kingdom. They give rise to extensive litigation and it is difficult to know to what extent the revenue is actually increased by the exercising of these powers. Unless the Minister should choose to give himself absolute powers to bring unbilled work into the income stream, which the Society sincerely hopes will not be a feature of any new tax law in Canada, it is as probable as not that discretionary powers would have only illusory value to the Revenue.

Legal Accounts not Receivables

With regard to the second of the matters dealt with particularly in the proposal, namely that amounts due from clients and not received should be included as income, it is emphasized that a lawyer's unpaid accounts prior to taxation are not legally receivable. For this reason a lawyer's accounts are not acceptable as collateral to bank loans and the lawyer does not have the opportunity open to a merchant or manufacturer to obtain funds with which to pay taxes in anticipation of the actual receipt of his accounts.

It is also the lawyer's frequent experience that his clients do not regard the lawyer's account as a claim which should be given favourable attention or priority, and in practice the lawyer having regard particularly to his professional status very infrequently resorts to court proceedings to accelerate payment.

In this submission no attempt is made to compare the lawyer's income earning activities with those of the other

professions. If it is the opinion of this Committee that the blanket permission presently accorded the professions at large to report income on a cash basis is not satisfactory, the Society is prepared to rely upon the well established judicial principle that the income of a taxpayer or group of taxpayers should be determined in a manner which properly reflects the nature of the income produced by the taxpayer's operations. If it is unsatisfactory to provide that a class of taxpayers shall be allowed to report income on a certain basis, it is equally unsatisfactory to say that all taxpayers must report income on another basis without exception. The Society submits that Parliament should impose prescribed courses of action on citizens as an adjunct to the collection of taxes only where it is abundantly clear that this is done in order to protect the revenues from serious erosion. It is submitted that deferment of tax payment by the use of the cash method arises only by comparison with the accrual method, and the duration of deferment is limited to the period of the lawyer's career in active practice. There is no information available on which to base an estimate as to the average duration of a lawyer's period of active practice, but it is in no way comparable to the continuity of business experience commonly enjoyed by corporations which have unlimited life. On the termination of a lawyer's practice such deferment of income as there may have been abruptly terminates by virtue of the provisions of Section 85F(4) of the present Act. It is emphasized that the use of the cash method of determining income by the lawyer does not result in the omission of amounts, except to the extent that an amount not included in the income of one year is included when received in the income of a subsequent year. It is submitted that the degree of prejudice to the Revenue resulting from this deferment is not of such a dimension as to justify imposing a method of

computing income on the legal profession which is, in the very great majority of cases, quite unsuited to the practice of law.

Submission

It is respectfully submitted that the reasons adduced in the White Paper for depriving the profession of the use of the cash method in reporting income are not persuasive in the face of the manner in which the profession carries on its activities and the statute should not be changed in this regard. More particularly, the Law Society, speaking on behalf of the whole profession, is strongly of the opinion that it would not only be oppressive but impractical to require the use of the accrual method as it relates both to unbilled time and unpaid accounts in computing lawyers' professional incomes.

All of which is respectfully submitted.

W. G. C. Howland
Treasurer.

March 11, 1970

APPENDIX «B»

NAME: THE LAW SOCIETY OF UPPER CANADA

SUBJECT: Accrual Basis of Accounting

Analysis of Appendix "A" by Senior Advisor

This Brief is submitted by The Law Society of Upper Canada on behalf of some 7,000 members of the Society, of whom about 5,500 are engaged in the private practice of law. The Brief was prepared after the Society had received a large number of written replies to a request for comment upon the White Paper.

The Committee's attention is called to the following remarks:

> "The attitude of the lawyers of the Province as expressed in this material is unanimous and determined opposition to the proposal in Paragraph 5.46." (Page 2 of brief)

> "It is the basic proposition in this submission that accrual accounting is not suited to the determination of income from the practice of law, and that by taking this position the Law Society is not seeking to obtain for its members 'an unwarranted advantage by comparison with the rest of Canadians'."
> (Pages 2 and 3 of brief)

> "The suggestion in the proposal that lawyers reporting on the cash basis 'omit' something that has commercial value comparable to an inventory of goods is, with respect, misleading."
> (Page 4 of brief)

> "The Society feels very strongly that the concept that the lawyers have inventories of unbilled time in respect of unfinished work at the end of a fiscal year which can be valued and included as income simply does not reflect the actualities of legal practice in Ontario and in Canada."(Page 8 of brief)

"If it is the opinion of this Committee that the blanket permission presently accorded the professions at large to report income on a cash basis is not satisfactory, the Society is prepared to rely upon the well-established judicial principle that the income of a taxpayer or group of taxpayers should be determined in a manner which properly reflects the nature of the income produced by the taxpayer's operations." (Page 11 of brief)

"If it is unsatisfactory to provide that a class of taxpayers shall be allowed to report income on a certain basis, it is equally unsatisfactory to say that all taxpayers must report income on another basis without exception." (Page 11 of brief)

"The Society submits that Parliament should impose prescribed courses of action on citizens as an adjunct to the collection of taxes only where it is abundantly clear that this is done in order to protect the revenues from serious erosion." (Page 11 of brief)

There is attached the usual summary of the present law, White Paper proposals and principal points of the Brief.

Name : LAW SOCIETY OF UPPER CANADA

Date Brief Received:

Principal Subject: Accrual Basis of Accounting

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 85F-1 of the Income Tax Act This section permits a taxpayer carrying on a profession to determine his income on a cash basis, as opposed to other taxpayers carrying on business who are required to use the accrual basis.	The proposals of the White Paper respecting accrual basis of accounting for persons carrying on a profession are contained in the following paragraphs: 5.46 Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.	Page 2 of the Brief The Brief points out that the White Paper is misleading in saying "Generally taxpayers who are in business must compute their taxable income on what is known as the accrual basis." That it was only in 1948 that it was established businesses engaged in trade and manufacturing should use the accrual method. That the Courts have made it clear that there are variations of income determining methods and that the full accrual technique is not necessarily suited to all forms of income earning activities. The Brief makes the position that in using the cash basis, the profession is not seeking to obtain "an unwarranted advantage by comparison with the rest of Canadians."

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.47 A problem would exist in switching professional taxpayers now on the cash basis over to the new system. This problem relates to their receivables and inventories at the date of the change over. For example, if 1971 is the first year of the new system, the problem would relate to the receivables and inventories as at the end of 1970. These amounts would not have been included in the taxpayer's 1970 income because they would not have been collected at that time. They would not be included in the 1971 income because they were earned before that time. To require that the entire amount be brought into 1971 income would impose an abnormal tax liability in that year. As a consequence, the government proposes that these taxpayers be entitled to bring these amounts into income over a number of years. Specifically, they would bring them into income as their total outstanding receivables and inventories are reduced. This amount would of course be in addition to the amount of their income computed on the accrual basis and would mean that they would be taxed on the greater of a cash-basis income or an accrual-basis income until they catch up to other Canadian businessmen.	<u>Page 3 of the Brief</u> The brief submits that it is incorrect to say "an exception to the general rule has for many years been made for taxpayers in the professions." <u>Pages 3 and 4 of the Brief</u> The brief points out that lawyers are not in "business " in the same way as are merchants and others engaged in commercial and industrial activities. The brief sets out the limitations under which lawyers function such as, they cannot advertize, communications between lawyer and client are privileged, the practice cannot be carried by or through a corporation, unlimited personal liability and fees are not ordinarily based on a contract and in many cases are subject to taxation by a court official.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 4 of the Brief The Brief makes the point that lawyer's unpaid accounts and unbilled time cannot be considered to be an "inventory" and at best is an asset which cannot be sold or disposed of. The Brief states that: (1) The suggestion in the proposal that lawyers reporting on a cash basis "omit" something that has commercial value is misleading, and (2) The statement that a lawyer obtains a "tax postponement" by means of the cash basis assumes something is earned when time is spent on clients' affairs. Page 5 of the Brief The Brief points out that it is a misconception to regard a lawyer's operations as giving rise to an hourly or daily profit, or even an entitlement to any profit,

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		which unless subjected to tax currently on some accrual basis will result in tax postponement. The Brief offers the comment that the alleged deliberate postponement of realization of income by deferring the rendering of accounts is no more than an attempt by the lawyer to average income, and that no other benefit results from such a practice. Pages 6 and 7 of the Brief The Brief sets out the variations in activities of lawyers and the differences which ensue as to when fee income might be received. Fees are not earned on a day-to-day basis. Page 8 of the Brief The Brief points out that in a very real sense the lawyer earns his fee only when the work is completed to the satisfaction of the client, and the amount received is then subject to agreement or taxation.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		The Brief states the ever-increasing amount of legal work which has to wait on department of government for processing and/or payment. Page 9 of the Brief The Brief points out the effects of the accrual method on the position of a young lawyer who could have no income left after payment of expenses and taxes on so-called inventory of unbilled time. Page 10 of the Brief The Brief states that a lawyer's unpaid accounts prior to taxation are not legally receivable. Page 11 of the Brief The Brief points out that the use of the cash method of determining income by a lawyer does not result in the omission of amounts, except to the extent that an amount not included in the income of one year is included when received in the income of a subsequent year.

APPENDIX C

THE BAR OF THE PROVINCE OF QUEBEC

SUBMISSIONS ON PROPOSALS FOR

TAX REFORM

All Quebec lawyers, some 3200 in number, form part of the Bar of the Province of Quebec. There is great diversity in the location, scope, size and nature of their various practices and the degree to which they may be carrying out their functions alone or in groups. All aspects of the White Paper "Proposals for Tax Reform" concern us deeply as members of, and advisors to, the general public. A number of our practitioners are associated with other lawyers throughout Canada in preparing a general submission which will be channeled through the Canadian Bar Association. The present observations are limited to the White Paper recommendation restricting the previous freedom of choice available for reporting professional income on a cash or accrual basis.

From the inception of the Income Tax Act in 1917 it has been acknowledged that the appropriate method for measuring professional income is a cash basis. Special study of the situation in 1955 led to a precise parliamentary enactment embodied in section 85F of the Income Tax Act ratifying this practice. It is not to be concluded, therefore, that the current arrangments reflect any oversight. Rather they mirror the considered opinion of Parliament at a time when it was able to consider this problem specifically rather than as an incidental aspect of many proposed tax changes.

Under the United States of America tax system, the cash basis is universally recognized as appropriate for lawyers. It is the acceptable method in the United

Kingdom, France and, indeed insofar as we are aware, everywhere else in the world. In the interest of obliterating any distinction between the professions and commerce, the White Paper proposes a measure which has not recommended itself anywhere else.

Income Tax must be paid on a cash basis. Ability to pay is dependent upon the receipt of cash with which to discharge the tax obligation. Even the Carter Report, from which the proposal presently under consideration appears to have emanated, made the initial observation that "We think that, in general, income of all kinds, other than from employment, business and property, should be brought into the tax base when received so that, in effect, the cash base would apply" (Vol. 3, p. 73.). In assimilating a profession to a business, of which more anon, it was acknowledged that "in our view, it would <u>create some hardship</u> to require all farmers and professional individuals to adopt the accrual method because of the accounting and liquidity problems which this might involve for those with relatively small incomes". (vol. 4 p. 250). (Italics ours). Thus even the authors of the original suggestion have admitted that the proposal now embodied in the White Paper imposes some hardship. Moreover, the hardship would bear upon clients and other members of the public as well as upon professionals.

In view of the foregoing, it would appear that the onus of establishing the validity of the recommendation must rest upon those who propose it. It may very well be that for lawyers with certain types of practices, the results would be immaterial and for others it may be reasonably tolerable. It is probably with these types of practices in mind that the proposal was made. We are deeply concerned that it does not fit all members of the profession justly and for many it would be harshly inequitable.

The White Paper objection to the cash basis is that "this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians". This affirmation appears, to say the least, curious when account is taken of all aspects. Professionals alone are denied the right to incorporate with its resultant low rate of income tax on the first $35,000 of income. Wherever it is fiscally advantageous so to do, all other Canadians have had the advantage - for our part we are not suggesting that it is unwarranted - of incorporating. Apart from the low rate factors, members of our profession have similarly been precluded from participating in the deductible corporate pension plans and other similar fringe benefits recognized under the Income Tax Act.

In calculating corporate taxable income, invariably on an accrual basis, deduction may even be made for unpaid salaries to controlling shareholders who are allowed to defer their own taxability thereon for as much

rule has been reaffirmed in section 18 of the Income Tax Act.

Obtaining qualification to practice involves a long difficult period of training - currently for Quebec lawyers a minimum of eight years at the university level during which the future professional earns little or no income. No one has ever suggested, nor are we now suggesting, that the cost of this "investment" might be written off against future taxable income in a manner analogous to the capital cost allowances available to businessmen.

The White Paper proposals are phrased as though most Canadians are on an accrual basis. The reverse is overwhelmingly the case. Lawyers are assimilable, for purposes of accurately measuring their income, to the great majority who earn their living through skill and personal effort. These report their income on a cash basis. No change is proposed for them.

A special rule must apply for merchants and manufacturers. A cash basis for determing income might be equally appropriate in their case except that, in a growing business, tax could be postponed for a long time by growing accumulation of inventory at the end of each fiscal period. No such flexible inventory acquisition is applicable to lawyers. It has been suggested by the Minister of Finance in appearances before the House of Commons Standing Committee on Finance Trade in Economic Affairs (January 16th, 1970) that professional persons might "put off billing in order to put off paying the tax on it". Before evaluating the significance of this

allegation we would also invite inquiry as to its relevance in the light of the other recommendations of the White Paper. Surely there is no intention to seek to punish professionals in the future, because of the understanding which we consider to be completely unfounded, for the reasons aforementioned, that they have had some advantage in the past.

The White Paper urges an income averaging procedure under which taxpayers who receive an exceptionally large amount of money in any one year by comparison with others will be protected against the upward impact of the progressive tax schedule. A key proposal is to fix maximum rates of personal income tax, no matter what the earnings, at a fifty per cent level. These two measures taken together go very far towards destroying any tax incentive for deferring income into a future period. In any event, in the harsh realities of most situations any undue deferring of billing not only postpones receipt of money but imperils ultimate realization.

Another suggestion of the Minister of Finance on the same occasion is to the effect that some lawyers may have deliberately left funds in trust accounts, which might have been transferred to fees, in the expectation that this would defer taxable income. The Minister acknowledged that to the extent that this has been a problem it has been cleared up by departmental action under the existing law. We therefore understand that this is not a justification for the proposed change. Indeed it would appear that because of the unfortunately long delays attending many legal matters the accrual system might accentuate any deferring of prepaid

income rather than otherwise.

The proposal seems to reflect the notion that legal services should be available only on the basis of cold blooded commercial considerations and should be accounted for accordingly. Members of our profession undertake an enormous amount of gratuitous legal aid services. Indeed they are not allowed to refuse such an assignment without valid cause. Lawyers do not operate a "credit department" to determine the acceptability and credit worthiness of any clients. Once a client has been billed, the account receivable does not take on the character of an asset to the extent that this applies generally in commerce.

Many lawyers will not under any circumstances sue a non paying client no matter what the provocation, delay or refusal to pay may be. Bills are not dispatched on the basis of payment in thirty, sixty or ninety days with suitable discounts for prepayment. Nobody ever collects any interest on delayed payments. Some clients, alss, never pay their bills even though they are quite able to do so. Other clients seek, and frequently obtain, adjustment of their accounts. Bar regulations provide for arbitration of accounts where requested. It must be appreciated that these accounts are not typically measurable precisely on the basis of any previous contractual agreement as would be a bill for merchandise bought and sold. They are not discountable. There are infinite degrees of variation in considering their potential collectability.

We appreciate, of course, that there may be a reserve for "bad debts" but our members would find it repugnant to be compelled to operate a "means test" in order to determine whether to demand payment of the account from a client or to exercise commercial pressures for payment. Any unbilled time proposals are completely unworkable. We are gratified to note that the Minister of Finance has recognized the need for some modification on this score. There can be no better solution than its complete abandonment. It is against the regulations of the Quebec Bar to value services exclusively on a time basis. Any effort to evaluate work in progress will involve an enormous, vexatious expenditure, we would respectfully call it waste, of time and effort which will not be productive of any returns whatsoever for the Revenue Department, for members of the profession or for the public.

The proposal is at variance with a principle embodied in certain of our by-laws such as section 81:- "In establishing the value of his professional services an advocate must bear in mind that he is participating in the administration of justice and so must avoid all methods and attitudes likely to give to his profession a commercial or profit-seeking character."

To be sure, there are some members of the profession who will not be affected by the change. This will include

lawyers with a type of practice which involves the collection of fees in advance and others who are exclusively concerned with the problems of large corporate clients who pay their bills with less challenge and more expedition. It is also appreciated that the total amount of taxable income over the life of the taxpayer will always be the same. We find it disturbing that the greatest burden will devolve upon the young lawyer embarking on his professional career or leaving an established office to practice on his own. He will immediately find that all of his expenses such as rent and payment of personnel must be met immediately in cash. Even if he is working very hard and has a relatively large clientele from the very outset, there will be a considerable gap between the expenditure of the effort and the receipt of payment for his services. A compulsory accrual system under which he must pay taxes on income not yet received or even receivable will greatly deplete his resources. There will be many situations where even though his income is substantially below the average of his older brothers of the profession, he will have to be paying far more of his actual receipts to the tax gatherer than remains to him. In some instances with receivables being realized as slowly as they are, even his total net cash receipts will not suffice to meet tax obligations. The new rule would also be unfair in that members of the profession serving the broad mass of the public - and generally those who are least exacting in demanding or enforcing payments from their clients-will be most disadvantaged.

It does not appear to us that any element of government revenue is involved at all. Indeed insofar as the young lawyers are concerned they will probably be paying taxes at a higher rate in subsequent years with retention of a cash basis than would apply on an accrual basis but at least they will be making the payments when they are in a position to do so. This evolution arises because the young lawyers practice is likely to grow, and the proportion of prompt paying clients to rise.

The proposals can only be disadvantageous to the public because of its impact on availability of services. Accepting a client will entail immediate tax obligations by the mere process of spending time on his behalf ever though compensation may not be ultimately forthcoming. In personal injury cases, lawyers may spend long years preparing for and awaiting trial. If they are to be taxable in advance of the time when they receive payment the prospects for victims to redress for damages suffered will invitably dwindle. Once a bill has been rendered, the White Paper would award a premium to the professional who adopts the most agressive collection practices while imposing a penalty on those who prefer to be courteous, patient, understanding and sometimes perhaps all too tolerant in their approach to accounts receivable. A great deal of social waste to no constructive purpose would be entailed in seeking to account for and to measure "unbilled time". Needless burdens would be imposed by saddling the tax administration authorities with insoluble prob[illegible] will be [illegible] arbitrarily

or not at all. Much of the time which should be devoted to serving clients will be absorbed in expensive record keeping.

The transitional arrangements combining the worst of both worlds will be doubly unjust in adding extra taxable income in the earlier period before the maximum rates have been adjusted downward as they are ultimately intended to be.

For all of these reasons it is respectfully submitted that the freedom of choice between the accrual and cash basis for professionals should be retained as being a far more appropriate measurement of income in relationship to ability to pay and as being more universally applicable to diversified forms of practice in serving the public.

APPENDIX «D»

NAME: BAR OF THE PROVINCE OF QUEBEC

SUBJECT: Cash or Accrual Basis of Computing Income

Analysis of Appendix "C" by Senior Advisor

This brief is submitted by the Bar of Quebec, whose membership comprises some 3,200 Quebec lawyers.

The brief is limited to commenting on the White Paper proposals restricting the previous freedom of choice available for reporting professional income on a cash or accrual basis, and dealing with the taxation of unbilled professional work in progress.

The brief sets forth the reasons why the present procedures should be retained and concludes with the following submission:

> "For all of these reasons it is respectfully submitted that the freedom of choice between the accrual and cash basis for professionals should be retained as being a far more appropriate measurement of income in relationship to ability to pay and as being more universally applicable to diversified forms of practice in serving the public."

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name : BAR OF THE PROVINCE OF QUEBEC

Date Brief Received:

Principal Subject: Cash or Accrual Basis of Computing Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 85F of the Income Tax Act This section permits persons who carry on (1) a profession, or (2) farming to elect to compute income on a cash basis, or to use the accrual basis. Unbilled amounts need not be taken into income if the accrual basis is used.	5.46 Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.	The brief sets out the reasons in favour of maintaining the present choice of alternatives, and on Page 9 submits: "For these reasons it is respectfully submitted that the freedom of choice between the accrual and cash basis for professionals should be retained as being a far more appropriate measurement of income in relationship to ability to pay and as being more universally applicable to diversified forms of practice in serving the public."

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.47 A problem would exist in switching professional taxpayers now on the cash basis over to the new system. This problem relates to their receivables and inventories at the date of the change over. For example, if 1971 is the first year of the new system, the problem would relate to the receivables and inventories as at the end of 1970. These amounts would not have been included in the taxpayer's 1970 income because they would not have been collected at that time. They would not be included in the 1971 income because they were earned before that time. To require that the entire amount be brought into 1971 income would impose an abnormal tax liability in that year. As a consequence, the government proposes that these taxpayers be entitled to bring these amounts into income over a number of years. Specifically, they would bring them into income as their total outstanding receivables and inventories are reduced. This amount would of course be in addition to the amount of their income computed on the accrual basis and would mean that they would be taxed on the greater of a cash-basis income or an accrual-basis income until they catch up to other Canadian businessmen.	

APPENDIX «E»

SUBMISSION

BY

RETAIL COUNCIL OF CANADA

TO

THE BANKING, TRADE AND COMMERCE COMMITTEE

SENATE OF CANADA

CONCERNING

THE WHITE PAPER ON TAX REFORM

Retail Council of Canada

74 Victoria Street, Suite 723,

Toronto, Ontario

March, 1970

SUMMARY OF
RETAIL COUNCIL OF CANADA SUBMISSION
CONCERNING THE FEDERAL WHITE PAPER ENTITLED
"PROPOSALS FOR TAX REFORM"

A. Description of Retail Council of Canada

Retail Council represents directly retailers who conduct some 40% of the country's entire retail store business. It also has, as affiliate members, most of Canada's specialist retail associations.

B. Scope of this Submission

We have limited our comment to those proposals which have some direct bearing on the retail trade. Our silence on other aspects of the White Paper should not be construed as either approval or condemnation.

C. Summary of Retail Council's Recommendations

1. Prior to implementation of any of the new proposals, the administration of the new tax system be clarified. (see page 4)
2. Introduction of the changes be paced to the expected ability of government, taxpayers and professional advisers to make necessary adaptions to such changes. (see page 5)
3. Discussions of rates should deal with rates expected to be in place when the system is fully operational and shortfalls caused by the lack of maturity of the system be dealt with by temporary adjustments. (see page 5)
4. Some of the new deductions from personal income, although desirable, be postponed until revenue considerations allow their introduction. (see page 5)
5. The cost of child care, up to the agreed figure, be deducted from the income of either parent where both parents are income earners. (see page 6)
6. The deduction for expenses related to earning employment income not be granted generally. Rather, it should be for identified expenses to an established maximum supported by evidence of the expenditures. (see page 6)
7. The test of reasonability of business expenses be used in determining whether they should be permitted as charges in determining business income. (see page 7)
8. The basic personal exemptions be increased as proposed. (see page 7)
9. Maximum rates of personal income tax be reduced to the vicinity of 50 per cent as proposed. (see page 8)
10. The level of income at which the maximum rate is imposed be raised say to $50,000. and some adjustment be made to rates in the ranges just under the maximum amount. (see page 8)

11. Should capital gains be included in ordinary income, the full rate of tax be applied on realisation during the first year of acquisition and reduced rates be applicable in one or more stages thereafter. (see page 9)
12. Shares in widely-held corporations not be revalued on a five-year basis. Rather, gains be included in income for tax purposes only upon the realisation of such gains. (see page 11)
13. The present methods for income averaging be retained. (see page 11)
14. Amounts that may be put in a pension plan or retirement savings plan be limited as proposed provided such limitation is cognisant of the practical problem of determining the total anticipated benefit of an employee with a variety of sources of retirement income. (see page 12)
15. Cooperatives and ordinary corporations of similar profitability should pay the same amount of tax and the provisions governing the taxation of co-operatives should be altered accordingly. (see page 12)
16. The proposal to regard "nothings" as depreciable assets be extended to include mortmain expenses, discounts on the sale of bonds, finders fees, incorporation expenses and trademarks. (see page 13)
17. Expenses of issuing shares or borrowing money currently covered by section 11(1)(cb) of the Income Tax Act be included in the proposed legislation on "nothings" in a manner identical to the existing legislation in this regard. (see page 13)
18. Additional opportunities be granted taxpayers to comment on proposals on goodwill when such proposals are crystallised by the Government. (see page 14)
19. The present low rate of tax on the first $35,000. of corporate income be retained and the Government not proceed to implement a uniform rate of tax for corporations at a rate of 50 per cent. (see page 13)
20. Full and public discussion of the proposal to integrate corporate and shareholder income be undertaken prior to its application. (see page 16)

D. Conclusion

While the submission by Retail Council is limited to those aspects of the White Paper of concern to retailers, it is important to realise that a broad spectrum of the Canadian economy is affected by developments within retailing. The Government is urged to give further consideration to those proposals of the White Paper which would increase the costs of doing business to retailers. Such increases could have serious implications for the industry and consequentially for most Canadians.

Because of the far-reaching significance of tax reform of this magnitude, Retail Council recommends that implementation of the new proposals should take place only following full consideration of all their ramifications to ensure that the proposed system will be appropriate to the needs of the public and private sectors for many years to come.

The Chairman and Members
Banking, Trade and Commerce Committee,
Senate of Canada,
Parliament of Canada,
Ottawa, Canada.

Gentlemen:

1. INTRODUCTION

.01 Retail Council of Canada is pleased to have this opportunity to make known its views on the Government's White Paper entitled "Proposals for Tax Reform". By no means all the reactions to the White Paper expressed in this submission are favourable; we are however pleased that the Government has adopted the wise course of providing the means for public expression of opinion before legislati e proposals are hardened.

.02 Membership in Retail Council is comprised of most of Canada's medium-sized and larger retailers, together with a representative cross-section of smaller retail establishments. Nationally, the Council represents directly retailers who conduct some 40 per cent of the country's entire retail store business. It also has, as affiliate members, most of Canada's specialist retail associations. The identity of those affiliates who have endorsed this submission will be filed with the Committee.

.03 The significant characteristics of the retail trade for current purposes can be summed up as follows:

(a) the large number of medium-sized and small business within it;

(b) its significance as a large employer (one in seven in the labour force find employment in the distributive trades); and

(c) its importance within the production/distribution/consumption cycle: any legislative measure which has adverse effects on the efficiency of the trade and inhibits the distributive process can have repercussive effects on the consumer and the producer.

.04 This submission has been prepared under the direction of the Council's Taxation Committee and its terms have been approved by our Executive Committee on behalf of the National Board. The membership has been supplied with a resumé of the submission's contents.

.05 On the subject of the quinquennial revaluation of capital gains and the treatment proposed for taxation and distribution of corporate profits (particularly so far as this subject relates to small and medium sized businesses) the views of our membership were surveyed by questionnaire. The viewpoints disclosed by the responses to these questionnaires are reflected in the submission.

2. SCOPE OF THIS SUBMISSION

.01 Comments made in this submission fall within two major categories. First, they deal with the effect of the new tax proposals on the consuming public. In this regard, our reactions for the most part are not unexpectedly favourable. Second, the submission examines those proposals which will affect the tax position of our membership. As such, we have attempted to demonstrate in a factual manner the actual effect of the White Paper's proposals on various sectors of our industry. Wherever possible, we have attempted to propose what we believe to be viable alternatives to those proposals contained in the White Paper with which we disagree. We have construed it as our duty to limit comment to those proposals which have some direct bearing on the retail trade. Our silence on other aspects of the proposals should therefore be construed neither as approval nor condemnation. Those of our members who are interested in such subjects may well wish to comment on them individually or in other groups as taxpayers and citizens.

.02 The retail industry is concerned primarily with those sections of the White Paper which deal with capital gains and with corporation income taxes. Retail Council's submission demonstrates that the implementation of the proposals made on these subjects would result in undue difficulties for many retailers and in a substantially reduced capacity for legitimate business expansion. In particular, the smaller or independent retailer would be adversely affected by these proposals.

3. CRITERIA FOR JUDGING A TAX SYSTEM

.01 In its presentation to the Royal Commission on Taxation, this Council outlined the effects and characteristics of a tax system which should be scrutinised in evaluating its effectiveness. These were:

(a) its equity;

and here we suggested that an important test was the extent to which persons of equal tax-paying capacity were required to pay the same amount of tax.

(b) its effect on allocation of resources;

we suggested that the degree to which the public use of resources has a positive or negative effect upon utilisation of assets in the private sector could be used as one of the tests to apply to that public use of resources.

(c) the extent to which the system contributed to economic stability by smoothing fluctuations in economic activity;

(d) its administrative effectiveness;

Hence, we suggested a tax system should be workable, carry out the intent of the legislation, and minimise the expense of enforcement and compliance.

.02 The basis for judging of a tax system proposed by the authors of the White Paper was by no means dissimilar. They indicated their purpose was:

(a) to establish a more equitable distribution of the tax burden among persons of similar circumstances and among groups of persons with different tax paying capacities;

(b) to establish a stable tax system which would permit investors to plan ahead with reasonable assurance as to the long-range tax consequences of their investment decisions;

(c) to establish a tax system which did not interfere with economic growth and productivity; and

(d) to establish a tax system which would encourage voluntary compliance. The system must, they suggested, appear to be equitable, to be broadly based and to be well administered. Finally, it must be capable of being understood by taxpayers - at least in general terms.

.03 As the Council and the authors of the White Paper appear to have a meeting of minds on the objectives of our tax system, it is clear that any difference of opinion between us is limited to varying interpretations of what the effect of specific proposals will in fact be. We believe the proposals we make for amendment of the White Paper's proposals meet the test of both groups of criteria.

4. COMPARISON WITH OTHER TAX SYSTEMS

.01 One further criterion for testing the suitability of a tax system is relevant: that is a comparison of its impact on individual and corporate tax-payers with the tax system of the United States and, to a lesser extent, other

developed western nations. The case for making a comparison with other systems, particularly the U. S., is well known and we shall not attempt to recapitulate it. We appreciate that in any such comparison, proper recognition should be given to the disparities in the size and strength of the economies involved and the manner in which the impact of the taxing system is affected by transfer payments made to taxpayers by governments (child allowance, old age pension, etc.) However, after giving allowance to these considerations, we believe the levels of tax proposed for those in the middle income groups may tend to encourage emigration to the United States. We also believe that aspects of the treatment of capital gains and the taxation of corporate income may discourage capital formation and retention in Canada.

5. ADMINISTRATION OF WHITE PAPER PROPOSALS

.01 Retail Council notes that, while the White Paper has proposed what must be regarded as a virtually new tax structure in many respects, it has not brought forward recommendations as to how this new tax structure would be administered. It is clear that no tax legislation can be enacted which will be so well drawn that it will require little, if any, administrative modification to make it equitable and workable. Canada's present tax legislation is effective to a very considerable degree because it is substantiated by regulations, administrative directives and practices developed from judicial decisions over many years which provide a day-to-day interpretation of the law that can be readily used by the private and public sectors alike.

.02 The Council fears that implementation of any or all of the White Paper proposals prior to a clear understanding by the Government and the public of the administrative procedures to be applied would be premature. It would probably result in confusion and in unnecessary and perhaps costly delays. For these reasons, Retail Council recommends that, prior to implementation of any of the new proposals, the administration of the new tax system be clarified.

.03 We believe that what is necessary is (a) the publication and dissemination to the public of relatively detailed information on how the system will function and what is expected of the taxpayer in complying with the new system (maintenance of records, etc.) (b) the evolution of machinery whereby corporate taxpayers can achieve prior definitions and binding agreements with the Department on the valuation of assets and the taxation effects of corporate reorganisations. Without such machinery, normal corporate structural changes would be fraught with a quite unacceptable degree of doubt.

.04 One further and more radical departure from the Government's stated intentions may well be considered desirable. Because there are so many imponderables implicit in the introduction of a taxation system so materially revised, it may well be prudent to pace the introduction of the changes to the expected ability of government, taxpayers and professional advisors to make necessary adaptions to it. It seems to us not at all unreasonable to propose the phasing in of integration of corporate/shareholder income one year, a capital gains tax the next, and so on, provided this procedure can be reconciled with the need to introduce certain aspects of the reforms in harmony with each other.

.05 These suggestions are by no means proposed as delaying tactics; they are suggested because we are realistically apprehensive regarding the confusion and economic waste which may be caused by the precipitate introduction of the new scheme before the means of its operation have been devised or assimilated.

6. LEVEL OF TAX FLOW

.01 The White Paper has proposed new methods of taxing income, both personal and corporate, which, while roughly equalling present income in the first year of the new system, would, it has been estimated, provide in excess of 600 million dollars more revenue than is produced by the present tax system at the end of five years. Even now the present system is capable of producing substantial surpluses over revenue needs, as has been recently demonstrated.

.02 The Council is extremely disturbed by a proposal for an increase in tax flow which is not related to specific government programmes. Surely the electorate is entitled to prior public discussion and parliamentary approval of new programmes prior to the passage of legislation to provide their financing. We believe that discussions of rates at this time should deal principally with the rates which are expected to be in place when the system is fully operational with the understanding that, in the interim, temporary adjustments will be necessary to make up shortfalls caused by the lack of maturity in the system.

7. PERSONAL INCOME TAX

.01 Retail Council believes the White Paper proposals to increase the number of deductions allowable in calculating personal income for tax purposes to be reasonable in principle. However, we are concerned with regard to the amount of additional revenue required to replace the tax revenue lost through these changes. It is obvious the White Paper, if taken as a complete package,

contains proposals for raising this extra revenue. We suggest that some of the new deductions from personal income, while desirable in themselves, can be regarded as postponable until revenue considerations allow their introduction.

Child Care Expenses (White Paper paragraphs 2.7 to 2.9)

.02 We believe the principle behind this proposal has merit. The White Paper states that the deduction would assist many mothers who work or want to work to provide or supplement the family income. It is not completely clear, but it is assumed that the deduction would be made only from the income of the wife. We note that the provisions will be of most assistance to professional and other relatively highly paid working mothers and of little assistance to mothers who work part-time and/or have low earning capacity. Of more benefit to the majority of families in which the mother works would be a provision enabling the cost of child care up to the agreed figure to be deducted from the income of either parent rather than from that of the wife only. It could still be a prerequisite, in the case of two parent families, that both parents be income earners but by allowing the deduction to be made from either income some help could be given the mother, without special skills and hence modest earning capability, who has the opportunity to take a part-time job. (This is the typical situation in the retail trade.)

.03 It seems to us such a modification of the proposal would be likely to stimulate a substantially larger number of women with young children to fill the opportunities which exist for them in the labour force.

.04 If the principle of our recommendations is accepted, it may be necessary, for revenue reasons, to adjust the permissible levels of deductions. We do not have the data to allow us to make any specific comment on this aspect of the subject. We recommend however serious consideration of the principle of our proposal.

Employment Expenses (White Paper paragraphs 2.10 to 2.15)

The General Deduction

.05 The White Paper recommends that a general deduction be introduced to assist persons with regard to their expenses related to the earning of employment income. We believe the reduction should not be granted generally but should be for identified expenses to an established maximum supported by evidence of the expenditures. This would require the clarification of permissible deductions. The general deduction is expensive because of the number of taxpayers involved. It confers a benefit on a number of employees who do not require deductions because they have no expenditures in this category. It is not of sufficient benefit to employees with substantial work-related expenditures.

Other Employment Expenses

.06 The White Paper recommends that the cost of convention attendance and like expenditures no longer be permitted as charges in determining business income. These recommendations appear to consider all expenditures of this type solely as fringe benefits existing for the pleasure of a company's personnel and its customers. In reality, this is not generally so. Most businesses exist to make a profit and are not liable to condone use of corporate funds for the entertainment of staff and customers where there is not a reasonable likelihood of expenditures eventually yielding profit.

.07 It is, of course, recognised that the expense account concept is open to some abuse. Retail Council does not believe, however, that significant abuse has been documented or even suggested, either by the White Paper or through Government statements. Nevertheless, the White Paper proposes to restrict large portions of expense account spending, seemingly in the hope of eliminating such minor abuses as may exist.

.08 Retail Council recommends the Government modify its views in this regard. We suggest that the test of the reasonability of such expenses, including conferences, conventions etc. should be used in determining whether or not they should be permitted as a charge in determining business income. In this way it should be possible to eliminate abuse while recognising that to some considerable degree this type of spending serves a useful business or community purpose.

.09 It is worth noting in parenthesis that most business conventions and conferences are today heavily oriented towards education of the participants in their technical trade specialities. Certainly our own Retail Council conferences are almost exclusively devoted to the educational function. Further, for the members of a small business, a conference is often no more than the equivalent of the in-house meeting of corporate personnel in a larger organisation. It is the vehicle for the small business man being introduced to new developments within his trade.

The Basic Exemption - Rate Schedules (White Paper paragraphs 2.2 to 2.4)

.10 The White Paper proposes that the basic personal exemption be increased to $1,400. from $1,000. for single taxpayers or for married persons filing as single persons. Similarly it proposes that the exemption for married taxpayers be increased to $2,800. from $2,000. Retail Council concurs with these proposals taking account as they do of the inflationary movements in the economy. Given the likelihood of continued periodic inflationary surges in the economy we appreciate it will be necessary for a review of both basic exemption levels and rate schedules to take place regularly.

Reduction of Maximum Rates (White Paper paragraphs 2.39 to 2.43)

.11 The White Paper proposes that maximum rates of personal income tax be reduced to the neighbourhood of 50 per cent in four instalments as the income from the proposed capital gains tax increases. This reduction will lessen Canada's present confiscatory maximum rates of personal income tax and the proposal is endorsed by Retail Council. Current maximum rates have a negative effect upon personal initiative, are obviously inequitable and provide a significant incentive for seeking loopholes and the establishment of elaborate tax reducing schemes.

.12 It is essential as we mentioned that, if the tax reform package proposed in the White Paper is instituted, the Government indeed lower maximum rates to the vicinity to 50 per cent at the time the new tax system is implemented. Otherwise, when the proposals (a) to include capital gains in personal income for tax purposes, (b) to allow tax credits only for dividends paid within two-and-one-half years from the end of a corporation's taxation year and (c) to permit closely-held corporations to be taxed as partnerships are considered, the new tax system would impose a burden of tax on many individuals which would be totally unacceptable. The Government should feel fully justified in implementing an immediate reduction in maximum rates. The full effect of its capital gains proposals will not be felt for some years while the effect of capital losses will be felt promptly. Persons in the present high tax brackets would be quick to declare capital losses to relieve themselves of the burden which the current rates impose. It is probable that these same people would not be particularly willing to realise capital gains if the current rate structure were maintained. Any temptation on the part of a Government to raise the maximum rate in the future must be resisted if gains are to be included in income.

.13 Retail Council is concerned that the maximum rate would be applicable to all taxable income in excess of $24,000. were the White Paper proposal to be adopted. While the justification for imposing the maximum rate at $24,000. is probably that the present rate structure imposes tax at 50 per cent on taxable incomes in excess of $25,000., we believe that by setting the maximum rate at this relatively low income level, the Government would not be in accord with one of the basic criteria we cited previously: that taxation should be related to ability to pay.

.14 In order to correct the inequities which would result from the imposition of maximum rates of tax at a level of $24,000., Retail Council urges the level of income at which this maximum rate is imposed be substantially raised. At

current values of money $50,000. seems a reasonable level at which to apply maximum rates. This would also involve some adjustment to rates in the ranges just under the maximum amount. However, the revenue repercussions at these income levels are not very substantial and are, we believe, worth countenancing.

8. INCLUSION OF GAINS IN ORDINARY INCOME

General (White Paper paragraphs 3.13 to 3.18)

.01 Retail Council argued against a tax on capital gains in its submission to the Royal Commission in January, 1964. At that time, its arguments against such a tax included the facts that the tax would to a substantial extent be a tax on inflation, it would require elaborate collection machinery and its worth as a revenue producer might not be proportionate to the cost of its maintenance to the economy. The form of the Government's proposal meets some, but by no means all, of our concerns.

.02 Two very real objections to this type of tax remain:

(i) The problems of retaining the control of existing and future Canadian enterprises within Canada will be intensified by the tax. Canadian holders of equity are likely to realise part of their holdings to pay the tax; and,

(ii) The tax will not distinguish between real and inflationary gains.

.03 We can conceive no absolute means of curing the first difficulty short of abandoning this form of tax. However, it could be alleviated by extending the period after which valuation takes place, as we demonstrate later. The second problem could be eased by adopting the principle behind the application of the U. S. capital gains tax whereby some recognition is given to the length of time an asset is held. The proposal we suggest is that the full rate of capital tax be applied on realisation during the first year of acquisition and the reduced rates be applicable in one or more stages thereafter.

.04 This system both catches the purely fortuitous or speculative gain and gives some, albeit imperfect, relief to the more usual longer term and, at least partially, inflationary gain.

The 5 Year Revaluation Proposal (White Paper paragraphs 3.32 to 3.38)

.05 The Council regards the proposal made in the White Paper that the shares of widely-held corporations be revalued every five years and subjected to tax according to a prescribed formula as potentially cumbersome from an administrative point of view and as almost certainly harmful to many segments of the business community.

.06 It seems obvious to Retail Council that the necessity to revalue on a quinquennial basis will create hardships for business in a variety of ways.

.07 The individual holding controlling shares in a widely-held corporation is liable to be forced to forfeit control through a distressed sale of shares. Also, if the shareholder owned a very substantial percentage of the company's stock his distressed sale of shares would, in all likelihood, depress the market value of all shares of the corporation.

.08 The possibility of either loss of control or of a depression in the value of shares could easily provide sufficient grounds to influence many smaller companies to remain closely-held rather than striving to become widely-held corporations. In addition, it would deter potential investors from buying shares in a relatively newly-formed, widely-held corporation which had not yet proven its capacity to survive a five-year revaluation without substantial dislocation.

.09 The effect of these deterring factors on the national economy would be significant. Closely-held companies with the potential for growth could be dissuaded from becoming widely-held and acquiring the funds necessary to finance such growth. The consequences of such reluctance would be the loss by the Government of potential extra revenue; additional employment would not be available to absorb Canada's ever-increasing labour force; other more severe repercussions might follow.

.10 The possibility of companies being vulnerable to foreign takeovers as a result of distressed sale of shares has attracted widespread public comment since the White Paper was released. Retail Council does not wish to dwell on these well-known arguments at length, beyond stating that we agree the threat of such foreign takeovers is genuine.

.11 We understand that because of the terms of the U. S./Canada Tax Treaty and the practicalities of its application, U. S. shareholders of Canadian corporations would not be required to carry out quinquennial revaluations.

.12 Given all these circumstances, it seems unfair to ask Canadian companies to accept this responsibility.

.13 While the administrative responsibility placed on the Department of National Revenue by the five-year revaluation would be substantial, the burdens placed on the private sector, were this proposal to become law, would be probably even greater.

.14 Retail Council recommends the Government not implement the White Paper proposal that shares in widely-held corporations be revalued on a five-year basis. Should the Government decide to introduce a capital gains tax, we recommend that gains be included in income for tax purposes only upon the realisation of such gains.

.15 A further problem arises in relation to the method of valuation of shares on valuation day. It seems to us that whatever the theoretical justification for taxing the gains occurring after valuation day in the value of shares which were purchased at prices higher than the valuation day price, the procedure will arouse understandable taxpayer opposition. One means of answering the problem is to allow the base price to be the higher of valuation day value or purchase price when determining the amount of gain subject to tax. This alternative would not of course be available in the event of a sale resulting in a loss.

9. INCOME AVERAGING (White Paper paragraphs 2.53 to 2.59)

.01 The proposed method for income averaging which is advanced in the White Paper does not constitute a particularly generous proposal as the example of the application of the formula set out on page 34 of the White Paper makes obvious. Income averaging is significant both because of the proposal for quinquennial valuations and taxation of capital gains and also from the aspect of equity.

.02 The principle of income averaging contained in the Income Tax Act, as currently in effect, is based upon tax aggregates as opposed to the tax threshold device proposed by the White Paper. The present system seems to Retail Council to constitute a truer form of income averaging than the proposal in the White Paper, a proposal which would be of no benefit to persons normally earning $18,000. or more per annum.

.03 It should be pointed out that income averaging is of benefit not only to persons realising a windfall, but is of importance to persons contributing to pension plans who leave their employment. Situations arise where a contributor is obliged to withdraw from a company pension plan upon termination of employment and is not able to invest his withdrawal in another pension plan. The lack of generous averaging provisions would place undue hardship on such an individual. In addition, substantial financial burdens would be placed on persons withdrawing from a deferred profit sharing plan. It must be remembered that, in the case of pension plan and deferred profit sharing plan withdrawals, the absence of generous averaging provisions would result in taxation of a significant portion of a taxpayer's bona fide life savings as opposed to a windfall he may have enjoyed.

10. RETIREMENT SAVINGS PLANS (White Paper paragraphs 2.45 to 2.52)

.01 The White Paper proposes the eventual adoption of a system to limit the amount that may be put into a pension plan or retirement savings plan in terms of the amount of the benefit expected on retirement rather than by reference to contributions. It further proposes that, in the interim, until revenue conditions permit adoption of such a system, existing limits based on contributions will be retained, except for certain specific lump sum payments into registered retirement savings plans.

.02 Retail Council has gone on record previously as believing that the test for eligibility of deduction of contributions to Registered Retirement Income Plans should be based on the level of anticipated benefits rather than on a restricted dollar amount of contribution in any particular year. Our only reservation in this regard concerned the practical problem of determining the total anticipated benefit of an employee with a variety of sources of retirement income. Provided this problem can be overcome, Retail Council recommends the Government implement this long-term proposal of the White Paper.

11. TAXATION OF COOPERATIVES (White Paper paragraphs 4.68 to 4.71)

.01 The Council believes the White Paper does not go far enough in redressing the imbalance which exists in the taxation of ordinary corporations and their shareholders on the one hand and cooperatives, credit unions, etc. and their owners on the other.

.02 In its submission to the Carter Commission, Retail Council made these points:

- Because of the broadly representative cross-section of economic groupings found among patrons of cooperatives, special tax treatment accorded cooperatives cannot be regarded as aid to an underprivileged or particularly deserving class of consumers or producers;
- Competition among profit-motivated enterprises is an adequate guarantee that the consumer will not suffer price exploitation;
- There is no evidence to suggest that cooperative activity in Canada has resulted in substantial and continuing price reductions;
- Special tax treatment provides cooperatives with a huge subsidy paid by all taxpayers in Canada; and,
- Retail Council does not believe the vast majority of Canadians feel the national interest is served by according cooperatives specially favoured tax treatment.

We believe these considerations are still relevant.

.03 The Council endorses the recommendations of the Equitable Income Tax Foundation in this regard and in particular its specific proposals:

(a) That the proposal set out in paragraph 4.68 for withdrawal of the 3 year exemption presently called for by Section 73 of the Act for new cooperatives be implemented;

(b) That the proposal set forth in paragraph 4.70 to increase the limit provided for in Section 75(3)(a) of the Act be implemented;

(c) That the proposal relating to interest deductible under Section 75(3)(b) be not implemented but that this section, if any interest is to be allowed therein, be amended to cover only interest paid to members on their loans on the conditions stipulated in Section 11(1)(c) of the Act, such interest not to have been claimed as a deduction under the last mentioned provision.

(d) That the Act be amended by repeal of Section 75(4)(f) and by the insertion of a clear and unequivocal statement that all payments of patronage dividends, interest or of any other nature by co-operatives to their members must be made currently and in cash or its equivalent.

(e) That patronage dividends be made taxable in the hands of the members of consumer cooperatives to whom they are so paid.

(f) That, in the case of caisses populaires and credit unions, clear and unequivocal language be employed in defining what they are to be entitled to deduct from taxable income as being comparable to patronage dividends.

12. "NOTHINGS" (White Paper paragraphs 5.4 to 5.8)

.01 The White Paper proposes a new class of assets would be established for those business expenditures which, under the present tax system, are neither deductible currently nor depreciable.

.02 Retail Council endorses the proposal that such assets should be depreciable. While the definition of the assets to be treated in the manner proposed has still to be clarified, we suggest it should include mortmain expenses, discounts on the sale of bonds, finders fees, incorporation expenses, and trademarks as "nothings".

.03 It is not clear to Retail Council whether the White Paper's proposal on "nothings" are meant to include expenses of issuing shares or borrowing money currently covered by section 11(1)(cb) of the Income Tax Act. In the event that the inclusion of such expenses was not contemplated, we recommend the Government

consider their incorporation in the final legislation in a manner identical to that currently in practice under section 11(1)(cb) whereby such expenses are immediately deductible. Our purpose in making these comments has been to endorse the White Paper's proposals on the principle of "nothings" and to suggest to the Government ways in which this principle could be usefully extended.

.04 We are uncertain as to how the Government intends to treat goodwill under this proposal. We believe that an opportunity should be given for taxpayers to comment on Government proposals here.

13. TAXATION OF CORPORATIONS

Closely-held Corporations (White Paper paragraphs 4.20 to 4.33)

.01 The White Paper has proposed significantly different methods for taxing smaller Canadian companies by eliminating gradually over a period of five years the present low rate of corporate tax on the first $35,000. of profits annually. As justification for this proposal, the White Paper stated that a uniform rate of corporate tax would result in greater tax equity between corporations, be they widely-held or closely-held, and between incorporated and unincorporated businesses.

.02 The likely impact of cancellation of the low rate of tax on the first $35,000. of corporate income was made the subject of a survey of our membership falling into the "closely-held" definition. The results of this survey indicate that a significant number of our independent members who are private companies would suffer very difficult problems in financing their continued growth and modernisation of their businesses if the Government decided to implement this proposal.

.03 The low rate of corporate tax admittedly does not satisfy the criterion of strict equity in taxation. However, the rationale which prompted the low rate was not based solely on a consideration of equity. Rather, the system was introduced by the Government as a measure designed to encourage small businesses to expand through reinvested earnings. The logic of this measure has long been recognised, by the public and private sectors alike, as sound, providing as it does incentive to those successful enterprises from which emerge the growth companies which, in their maturity, enrich the whole economy and provide new jobs for our rapidly expanding labour force.

.04 While the White Paper proposal appears to produce a greater measure of tax equity between incorporated and unincorporated business, it must be acknowledged that this equity will be achieved at the expense:

(a) (i) of removing a necessary source of capital for expansion of particular utility to small but successful companies in the difficult period of their development. Typically, at one stage of their growth they have exhausted all available sources of additional capital and are not large enough or do not have a sufficiently long and consistent earning pattern to permit them to become public corporations;

(ii) of reducing additional after-tax revenue which to some extent compensates small corporations for the difficulties of doing business as a small unit. (It is true that unincorporated businesses do not derive similar benefits. However, successful unincorporated businesses are likely eventually to become incorporated, at least in those sectors of the economy where they are likely to become important as creators of wealth, employment etc.); and,

(b) of impairing the ability of some small corporations to honour their long term obligations to which they have committed themselves in the expectation of perpetuation of present provisions or substitutes of equal value.

.05 Many suggestions of alternative methods which could be utilised to ease the burden of financing of small business have been made. These suggestions include, among others, accelerated capital cost allowances up to certain maximum limits, and government grants or low cost loan schemes. Each such suggestion involves its own set of problems and many would require the substitution of administrative judgments by the public sector as to the eligibility or desirability of a proposed expansion plan, under rigid legislative rules, for the normal process of business decision making. Before accepting any such suggestion, Retail Council is hopeful that the Government will gauge whether any substitute plan meets, as flexibly as does the present system, the unique needs of small companies.

.06 In any event, the proposal for integration, if implemented, will mean that the reduced rate will merely constitute a deferral, and not an absolute reduction, of tax revenue. The value of the deferral to the growing corporation would be considerable and argues for its use.

.07 A major concern of the Government appears to be that many taxpayers have not been content with obtaining the low rate of tax on $35,000. of business income. The White Paper states that by incorporating several companies some businesses have sought to multiply this sum several times over. It continues by explaining that the almost infinite flexibility in the share structures of corporations has made it possible for some to keep one step ahead of every change in the law designed to restrict taxpayers to one amount of $35,000. annually.

.08 After the appointment of the Royal Commission, the Minister of Finance introduced Section 138A(2) to the Income Tax Act. The wording of this section and the power which it gives the Minister of Finance is, in the opinion of the Council, sufficient to deal with the problem of associated companies abusing the low rate on the first $35,000. If, as the White Paper suggests, abuse is continuing to take place it would appear not that the legislation is inadequate but rather that enforcement procedures have been lacking. The full impact of Section 138A(2) was not felt until subsequent to the preparation of many of the briefs presented to the Royal Commission and accordingly, what appeared to be a problem at the time has since been resolved by the introduction of the wide ranging ministerial discretion provided by this section. In short, Retail Council believes that the remedy for the cure of the associated corporation problem in Canada already exists.

.09 Since Retail Council of Canada does not consider the case for abolishing the low rate of tax on the first $35,000. of corporate income has been established, it is recommended that the present rate structure be maintained and that the Government not proceed to implement a uniform rate of tax for corporations at a rate of 50 per cent as has been proposed.

.10 If it is felt that simple perpetuation of the system exactly in its present form is not acceptable then we recommend that the low rate be available to companies only when an agreed upon and substantial amount of the tax thus saved is retained in the company and is not used solely for distribution to the shareholders. The Council feels a procedure could be developed along these lines which would meet the needs of smaller companies.

Intregration of Corporate/Shareholder Income (White Paper paragraph 4.24 and following paragraphs)

.11 The integration proposals have some theoretical justification. However, they do present some substantial, and to our knowledge still unresolved problems of achieving equity in practice. We believe this is another feature of the pro-

posed tax system which necessitates full and public discussion of the proposal prior to its application. In any event, we believe that the retention of the current system of providing incentives to small corporations, or an acceptable variant of it, would not inhibit introduction of the integration proposals. We have not dealt exhaustively with this particular problem because of the wide diversity of situations which arise. These problems must, however, be solved fairly before introduction of the proposal.

14. CONCLUSION

.01 The specific comments contained in this submission relate directly to the impact of the White Paper on the retail industry. However, the consideration of the terms of the submission by the Government should take place within a broad context which recognises that a wide spectrum of the productive, distributive and consuming segments of the national economy are affected directly by developments within retailing. We recommend particularly that the Government give further consideration to those White Paper proposals which this submission has indicated would place additional, and in some cases substantial burdens related to tax levels and administration upon the retail industry. To do otherwise would be to disregard the consequences to most Canadians of increasing the cost of doing business at the retail level.

.02 Tax reform of the scope proposed by the White Paper occurs only infrequently. It follows, therefore, that such reform must result in a tax system which is recognised as superior in all its aspects to the system which it replaces. Retail Council recommends that the Government accord full consideration to all serious representations which are being made to it at this time concerning the White Paper. Implementation of the new proposals should not be carried out with strict reference to a predetermined timetable. Rather, it should be undertaken only as a result of full deliberation to ensure that the proposed system will assuredly be appropriate to the needs of the public and private sectors for many years to come.

All of which is respectfully submitted

RETAIL COUNCIL OF CANADA

A. J. McKichan, General Manager

J. D. Muncaster, President

March, 1970

APPENDIX «F»

NAME: RETAIL COUNCIL OF CANADA

SUBJECT: Comments upon White Paper Proposals

Analysis of Appendix "E" by Senior Advisor

This Brief is submitted by the Retail Council of Canada. The Council is an association representing 40% of the country's entire retail store business. and also has as affiliated members most of Canada's specialist retail associations.

The Brief has limited its comments to those proposals of the White Paper that have a direct bearing on the retail trade. It also contains the qualification that silence on other aspects of the White Paper does not constitute approval or condemnation.

The contents of the Brief consist of:

(1) General comments on the White Paper proposals. (Pages 1 to 5, comprising paragraphs 1 to 6).

(2) Child Care Expenses. (Page 6, paragraphs 6.02 to 6.04).

(3) Employment Expenses. (Page 6, paragraph 7.05).

(4) Costs of Attending Conventions. (Page 7, paragraphs 7.06 to 7.09).

(5) Personal Exemptions. (Page 7, paragraph 7.10).

(6) Limitation on Maximum Tax Rates. (Page 8, paragraphs 7.11 to 7.14).

(7) The Capital Gains Tax. (Page 9, paragraph 8).

(8) Income Averaging. (Page 11, paragraph 9).

(9) Retirement Savings Plans. (Page 12, paragraph 10).

(10) Taxation of Co-Operatives. (Page 12, paragraph 11).

(11) Goodwill and Other Intangible Assets. (Page 13, paragraph 12).

(12) Lower Rate of Tax on first $35,000 of Taxable Income of Corporations. (Page 14, paragraphs 13.01 to 13.10).

(13) Integration of Corporation and Personal Taxes. (Page 16, paragraph 13.11).

The recommendations contained in the Brief are:

1. Prior to implementation of any of the new proposals, the administration of the new tax system be clarified. (See page 4)

2. Introduction of the changes be paced to the expected ability of government, taxpayers and professional advisers to make necessary adaptions to such changes. (See page 5)

3. Discussions of rates should deal with rates expected to be in place when the system is fully operational and shortfalls caused by the lack of maturity of the system be dealt with by temporary adjustments. (See page 5)

4. Some of the new deductions from personal income, although desirable, be postponed until revenue considerations allow their introduction. (See page 5)

5. The cost of child care, up to the agreed figure, be deducted from the income of either parent where both parents are income earners. (See page 6)

6. The deduction for expenses related to earning employment income not be granted generally. Rather, it should be for identified expenses to an established maximum supported by evidence of the expenditures. (See page 6)

7. The test of reasonability of business expenses be used in determining whether they should be permitted as charges in determining business income. (See page 7)

8. The basic personal exemptions be increased as proposed. (See page 7)

9. Maximum rates of personal income tax be reduced to the vicinity of 50% as proposed. (See page 8)

10. The level of income at which the maximum rate is imposed be raised, say, to $50,000 and some adjustment be made to rates in the ranges just under the maximum amount. (See page 8)

11. Should capital gains be included in ordinary income, the full rate of tax be applied on realization during the first year of acquisition and reduced rates be applicable in one or more stages thereafter. (See page 9)

12. Shares in widely-held corporations not be revalued on a five-year basis. Rather, gains be included in income for tax purposes only upon the realization of such gains. (See page 11)

13. The present methods for income averaging be retained. (See page 11)

14. Amounts that may be put in a pension plan or retirement savings plan be limited as proposed provided such limitation is cognisant of the practical problem of determining the total anticipated benefit of an employee with a variety of sources of retirement income. (See page 12)

15. Cooperatives and ordinary corporations of similar profitability should pay the same amount of tax and the provisions governing the taxation of cooperatives should be altered accordingly. (See page 12)

16. The proposal to regard "nothings" as depreciable assets be extended to include mortmain expenses, discounts on the sale of bonds, finders fees, incorporation expenses and trademarks. (See page 13)

17. Expenses of issuing shares or borrowing money currently covered by section 11(1)(cb) of the Income Tax Act be included in the proposed legislation on "nothings" in a manner identical to the existing legislation in this regard. (See page 13)

18. Additional opportunities be granted taxpayers to comment on proposals on goodwill when such proposals are crystallized by the Government. (See page 14)

19. The present low rate of tax on the first $35,000 of corporate income be retained and the Government not proceed to implement a uniform rate of tax for corporations at a rate of 50%. (See page 13)

20. Full and public discussion of the proposal to integrate corporate and shareholder income be undertaken prior to its application. (See page 16)

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Child Care Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not permit the deduction from income of this type of expense.	1.33 Costs of looking after young children when both parents are working, or when there is only one parent and that parent is working, would be allowed as a deduction subject to certain conditions. This new plan is intended primarily to benefit mothers who need to work to support their families, and would be in addition to the normal exemption for children. The maximum expenses allowed would be the lower of \$500 per child under age 14 or \$2,000 per family. 2.7 We propose to permit deduction of the child care expenses that face many working parents today. The problem of adequately caring for children when both parents are working, or when there is only one parent in the family and she or he is working, is both a personal and a social one. We consider it desirable on social as well as economic grounds to permit a tax deduction for child care expenses, under carefully controlled terms, in addition to the general deduction for children.	Page 6, paragraphs 6.02 to 6.04 of Brief This portion of the brief endorses the White Paper proposals. It recommends that the deduction be allowed against the income of either husband or wife to assist the wife who is working only part time.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.8 Costs to be deducted would include baby-sitting expenses, day nursery care and, up to $15 a week, lodging paid at boarding schools and camps. Amounts would be deductible up to $500 per child under the age of 14, or $2,000 per family. The total allowed would also be no more than two-thirds of the earned income of the parent with the lower earned income; it would be necessary to ensure that in fact there is not a parent at home. Deductions would have to be supported by receipts and could not be claimed for payments for care of a child by a person claimed by a taxpayer or the taxpayer's spouse as a dependent relative.	

Name: RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Employment Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act permits no such deduction.	1.32 The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.	Page 6, paragraph 7.05 of Brief This portion of the brief that deductions proposed to be allowed for employment expenses: (a) be supported by vouchers, and (b) be denied to all who cannot support their claims, and (c) no limit of $150 be imposed.

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Costs of Attending Conventions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 11-1-(ia) of the Income Tax Act and Information Bulletin No. 38 of March 23, 1968 These sections permit a taxpayer who is carrying on a business or profession to deduct from income the costs of attending not more than two business conventions in a year.	2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.	Page 7, paragraphs 7.06 to 7.09 of Brief This portion of the brief recommends that the White Paper proposals respecting conventions not be adopted.

Name: RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Personal Exemptions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	1.25 To remove or reduce taxes on lower-income taxpayers the government proposes to increase the basic personal exemption for a single person to $1,400 from $1,000 and for a married couple to $2,800 from $2,000. The basic standard deduction available in lieu of deductions for charitable donations and medical expenses would remain at $100. Consequently those taxable as single persons with income under $1,500 would have no tax to pay and those taxable as married would have no tax to pay if their incomes were under $2,900. These new exemptions would be much higher than those in other countries as shown in Table 3 page 26.	Page 7, paragraph 7.10 of Brief This portion of the brief endorses the White Paper proposals respecting personal exemptions.

Name: RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Limitation on Maximum Tax Rates

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act contains no such limitation.	2.42 The government has concluded that as the taxation of capital gains becomes fully effective, and transitional measures in the new system have ceased to be important, top rates of combined federal and provincial personal income tax should be reduced to 50 per cent. The top rates should gradually be reduced from the present levels, in four instalments commencing in the second year in which the new system applies. 2.43 After this change becomes fully effective the rates of tax on those who now report taxable income in excess of $40,000 would be lower than at present but as result of proposed changes in the taxation of corporations and corporate distributions, restrictions on expense deductions and the inclusion of gains, the amount they have to report as income for tax purposes would be substantially increased. The taxes on capital gains would be paid mainly by those in the higher brackets and after the first few years should produce hundreds of millions of dollars. This increase in the tax base is a far better way of taxing the wealthy than having ostentatiously high rates on an incomplete tax base.	Page 8, paragraphs 7.11 to 7.14 of Brief This portion of the brief endorses the White Paper proposal, but suggests: (1) The proposed reduction be implemented immediately, and (2) The proposed limit of $24,000 be raised substantially.

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: The Capital Gains Tax

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act does not impose tax on capital gains.	The proposals of the White Paper respecting capital gains were reviewed on Pages 8 to 20 of the special study entitled "Discussion of Principal Points of White Paper - Part 2" submitted on February 11, 1970.	Page 9, paragraph 8 of Brief This portion of the brief offers the following recommendations: (1) That the full rate of tax on capital gains be applied on realization in the first year of acquisition and at reduced rates thereafter. (2) That the five year revaluation proposal not be implemented (3) That values on valuation day be set at the higher of cost or value on valuation day.

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Income Averaging

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act contains nothing comparable to the White Paper proposals.	2.55 The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need for keeping records. Moreover, the system proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes. 2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.	Page 11, paragraph 9 of Brief This portion of the brief recommends against the adoption of the White Paper proposals.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level". 2.59 A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependants' deductions have been granted. It is therefore proposed that a married person may use for averaging only an unbroken series of years after being claimed as a dependant by his or her marriage partner. A person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay. These rules are not wholly satisfactory, but no simple and practical alternative has been found. Those prevented by such rules from using more than, say, two previous years for averaging might be permitted to assume an arbitrary income of $5,000 per year in the years excluded.	

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Retirement Savings Plans

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act places a maximum limit upon amounts which an employer, an employee or a self-employed person may deduct from income in respect of contributions to a retirement fund.	2.49 Establishing an effective, fair system based on a benefit limit is not easy. There are many different formulas for determining pension benefits, and it is necessary to be able to determine equivalents among these formulas, meanwhile bearing in mind the variety of survivors' benefits and fringe benefits attached to the modern pension plan. Moreover, some of the formulas are based upon contributions rather than earnings. Under these plans it is necessary to take into account the likely yield on investments over a long span of years and the likely increase in one man's pension as a result of other employees leaving and forfeiting part of the funds tentatively at their credit.	Page 12, paragraph 10 of Brief This portion of the brief endorses the White Paper proposals, provided a satisfactory solution can be found to determine the total anticipated benefits of an employee.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.50 While it is difficult to work out, the government believes in principle that such a system should be established. Unfortunately it is estimated that removal of the contribution limits would be quite expensive, and revenue considerations prohibit a switch at this time. Consequently we propose to retain the existing limits based on contributions, for the present, except for certain types of specified lump-sum payments into registered retirement savings plans. We also propose that plans that are primarily for the benefit of shareholders be denied registration until the switch is made to a benefit limit. The present contribution limits should be sufficient over a period to produce, along with the Canada Pension Plan and the old age security pension, reasonable retirement incomes. We suggest that any limits, whether on contributions or benefits, should be reviewed, perhaps every five years, to see that they are in reasonable accord with changing circumstances and prospects.	

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.51 Most pension funds now are subject to regulation under the Pension Benefits Standards Acts of the provinces or of Canada. These control the investments of pension funds in a manner generally adequate for tax purposes. However, it is essential to be sure that tax-free funds cannot be diverted through investment in such a way as to bring current benefits to those who contribute to them and control them, and to provide sanctions to be applied when investments are made contrary to the rules. With adjustment to meet these two points it is proposed that the rules applying to invesment of pension funds be the same as under the provincial and federal laws respecting pension plans. For registered retirement savings plans the permitted range of investments could be somewhat broader.	

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.52 Three other changes are also proposed. First, the savings withdrawn from these plans would be taxed at ordinary rates, even if the amounts are withdrawn at the death of the contributor. A widow would be permitted to offset or reduce this income if she contributes all or part of the proceeds to a registered retirement savings plan of her own. Second, rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets. Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other foreign investments.	

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.45 For many years our income tax law has permitted contributions to approved pension funds to be deducted from income in calculating tax, and has given tax-free status to earnings on the investments of such plans. Amounts paid out in pensions or other benefits are taxable in full. In 1957, in order to make similar benefits available to self-employed persons or others not in pension plans, Parliament enacted a special section providing for registered retirement savings plans. Under such plans contributions paid into a trust fund are deductible from income for tax purposes, investment earnings on the fund are exempt from tax, and the amount accumulated in the fund must be paid out as an annuity to the taxpayer, or an annuity to him and his wife. Such annuity payments are fully taxable.	

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.46 Tax is thus deferred on savings invested in a pension plan or retirement savings plan and also on the yield from these accumulating savings. This is a great advantage over having to save a similar sum out of income from which tax must first be paid out and then to pay tax on the return on the investment. The extent of the advantage depends on the tax rates of the saver at various times, on the rate of return on the investment and on the length of the period until repayment. The royal commission showed that under approved plans it is possible at interest rates of 7 per cent with only 20 years of saving to get a 50-per-cent greater after-tax retirement income than by saving and investing outside such plans. With 40 years of saving, say from age 25 to 65, it is possible to double the after-tax retirement income. This is a valuable tax concession to persons able to take advantage of it. The royal commission recommended that this treatment of approved plans be continued, but on a carefully rationed basis, calculated by reference to the retirement annuity the plan would provide.	

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.47 The government believes it desirable to encourage these personal savings plans for retirement. But it must be done on an equitable basis, available to all and subject to fair and reasonable limits. The government also believes that the tax-free trusts for retirement plans should not be entitled to the credit for corporation income tax proposed for dividends on shares in Canadian corporations. Freedom from tax on dividends and interest and capital gains should be sufficient. 2.48 At present, the tax act sets limits on the amount of the contributions to such plans that a taxpayer can deduct each year. As a result, taxpayers who can save regularly throughout their lifetime can provide for larger retirement incomes out of before-tax income than those who are able to save only during limited periods. In principle, the limits on what may be put into such tax-free savings funds by or on behalf of an individual can most fairly be established in terms of the benefit the fund can be expected to provide on retirement. This would equate the position of late savers with that of regular savers.	

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Taxation of Co-Operatives

<table>
<tr><th>Present Tax Law</th><th>Tax Reform Proposals</th><th>Principal Points of Brief</th></tr>
<tr><td>Section 75 of the Income Tax Act

This section permits a co-operative to deduct patronage dividends paid when computing income, but provides that income cannot be so reduced to less than 3% of the capital employed.

Section 73 of the Income Tax Act

This section exempts from tax for a period of three years the income of a new co-operative.</td><td>4.68 Two rules in the act have a special significance for co-operatives. One provides that a co-operative shall be exempt from income tax for the first three years of its existence. It is proposed that this exemption be withdrawn. If the rules that govern the tax position of co-operatives in the fourth and subsequent years are fair, they should apply to the first three years as well.

4.69 The second rule provides that patronage dividends are deductible in computing the taxable income of the co-operative, subject to a limit. Patronage dividends are deductible before interest paid (other than interest to a bank or credit union) and cannot reduce profits at that point in the computation below 3 per cent of capital employed. This might be thought to ensure that members are taxed on some return on their investment in the co-operative. However, the 3 per cent is far too low in current circumstances. Further, because such other debts as mortgages are taken into account in determining the capital employed, the effective interest taxed to members can be even lower than 3 per cent. (A $200,000 mortgage at an interest rate of 7½ per cent would result in no taxable return on members' investment of $300,000.)</td><td>Page 12, paragraph 11 of Brief

This portion of the brief endorses the following recommendations of the Equitable Income Tax Foundation:

(a) That the proposal set out in paragraph 4.68 for withdrawal of the 3-year exemption presently called for by Section 73 of the Act for new co-operatives be implemented.

(b) That the proposal set forth in paragraph 4.70 to increase the limit provided for in Section 75(3)(a) of the Act be implemented.</td></tr>
</table>

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	4.70 The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans—that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends.	(c) That the proposal relating to interest deductible under Section 75(3)(b) be not implemented but that this section, if any interest is to be allowed therein, be amended to cover only interest paid to members on their loans on the conditions stipulated in Section 11(1)(c) of the Act, such interest not to have been claimed as a deduction under the last mentioned provision. (d) That the Act be amended by repeal of Section 75(4)(f) and by the insertion of a clear and unequivocal statement that all payments of patronage dividends, interest or of any other nature by co-operatives to their members must be made currently and in cash or its equivalent. (e) That patronage dividends be made taxable in the hands of the members of consumer co-operatives to whom they are so paid.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(f) That, in the case of caisses populaires and credit unions, clear and unequivocal language be employed in defining what they are to be entitled to deduct from taxable income as being comparable to patronage dividends.

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Goodwill and Other Intangible Assets

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Goodwill and most other intangible assets cannot be amortized against income under the present Income Tax Act.	5.4 There is a class of expenditure incurred by businesses that is not deductible, either in the year in which the expenditure is incurred or over a series of years. The taxpayer is prohibited from deducting them in the year in which they are incurred because they are capital expenditures. He is prohibited from deducting the cost over a number of years by way of depreciation because they do not give rise to an asset for which provision is made in the depreciation regulations. Perhaps the best known of these capital nothings is goodwill. If a Canadian buys a business, he can neither deduct nor depreciate the portion of his purchase price that relates to the goodwill of the business. 5.5 The government proposes to create a new depreciation class which would sweep up all of these nothings and which would enable the taxpayer to deduct 10 per cent of the book value of this class each year. We believe that the 10-per-cent rate is fair if one takes into account the type of expenditure to be included.	Page 13, paragraph 12 of Brief This portion of the brief endorses the White Paper proposal that the cost of acquisition of goodwill be treated as a depreciable asset.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.7 The goodwill of a business has been described as the value that can be placed on the fact that customers are more likely to trade with that firm than with a new firm in the same line. This likelihood arises in part as a result of advertising and in part because customers have been satisfied in their past dealings with the firm. Clearly, goodwill is a thing that must be kept up. If a firm stops advertising or if it stops giving satisfactory service, its goodwill will disappear. Therefore, the goodwill that a firm has now is the result of its past actions, and the goodwill that it has five years from now will be the result in part of its past actions and in part of its actions in the next five years. The government proposes to recognize this fact in the treatment of taxpayers who sell goodwill in the future. The longer the period after the beginning of the new system before the sale takes place, the more of the proceeds of sale that would be taxable and the smaller the part of the proceeds that would be exempt.	

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.8 Another fact must be taken into account in setting the treatment of early sales of goodwill: purchasers would be willing to pay more for goodwill under the proposed system (since they can deduct the expenditure for tax purposes over a period of years) than they are willing to pay under the existing system. With these factors in mind, the government proposes that taxpayers who sell goodwill in the first year of the new system would be taxable on 40 per cent of the proceeds and exempt on 60 per cent; if in the second year, taxable on 45 per cent and exempt on 55 per cent; and so on, with the taxable portion increasing by 5 percentage points each year until the thirteenth year when 100 per cent of any proceeds would be taxable. Naturally, if a sale of goodwill involves a business that was not in existence when the new system commences, all of the proceeds would be taxable even though the sale takes place before 12 years have passed.	

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Lower Rate of Tax on first $35,000 of Taxable Income of Corporations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	The White Paper proposals relating to this subject were reviewed in Special Study No. 5 - Taxation of Small Businesses.	Page 14, paragraphs 13.01 to 13.10 of Brief This portion of the brief recommends that the present rate structure be maintained.

Name : RETAIL COUNCIL OF CANADA

Date Brief Received:

Principal Subject: Integration of Corporation and Personal Taxes

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	The White Paper proposals were reviewed in Special Study No. 4 - Grossing Up of Canadian Dividends.	Page 16, paragraph 13.11 of Brief This portion of the brief recommends retention of current system.

APPENDIX «G»

McLAUGHLIN, MAY, SOWARD, MORDEN & BALES
BARRISTERS, SOLICITORS, NOTARIES

TELEPHONE 368-2385
CABLE ADDRESS "LINTON, TORONTO"

HUGH J. McLAUGHLIN, Q.C.
ROWLAND F. MAY, Q.C.
REGINALD H. SOWARD, Q.C.
W. D. S. MORDEN, Q.C.
LLOYD A. MAY, Q.C.
A. DAVID McFALL
ROBERT N. McLAUGHLIN
JAMES H. McLAUGHLIN
REGINALD A. HUMMEL
WILLIAM W. MARKLE
DAVID W. ROSS

HON. DALTON A. BALES, Q.C., M.P.P., (1949-68)

200 UNIVERSITY AVENUE
TORONTO 1

27th February 1970.

The Chairman and Members,
The Standing Senate Committee
on Banking, Trade and Commerce,
Ottawa, Canada.

Sirs:

This submission is limited to a consideration of the proposals contained in Section 5.46 of Chapter 5 of the White Paper by which professionals would be required to adopt the accrual basis of computing their taxable income by including in such income not only billed but unpaid accounts, but also the value of unbilled time, the "inventory" to use the phrase of the White Paper. We have no quarrel with treating billed but unpaid accounts as income since this is a well-established and easily understood and administered system, provided reasonable and adequate safeguards are available to prevent an abnormal tax liability in the transitional period, but exception is taken to the proposition that the inventory of unbilled time should be valued, brought into income and taxed.

McLAUGHLIN, MAY, SOWARD, MORDEN & BALES

The Chairman and Members,
The Standing Senate Committee
on Banking, Trade and Commerce, 27th February 1970.

- 2 -

It is only too obvious that the tax revenues from the legal profession will increase in the first year under the proposal since the "inventory" as well as all cash receipts will be brought into taxable income. It is equally obvious that thereafter the taxable income of the lawyer will revert to its former norm or average. Against the admitted advantage in one year to the government, what is the legacy left the practitioner from Corner Brook to New Westminster? The legacy, we submit, is a sharply increased cost of doing the same business by reason of the imposition of a wholly unnecessary and non-productive system of bookkeeping.

In order to keep track of one's inventory it will be necessary for every lawyer in Canada to establish and maintain a meticulous docket or time recording system. To the half hours, hours or days of time expended on any particular matter will, in theory, be accorded a dollar value, which in the final result will probably bear little relationship whatsoever to the final issued bill, since the latter depends on such unpredictable factors as importance to the

McLAUGHLIN, MAY, SOWARD, MORDEN & BALES

The Chairman and Members,
The Standing Senate Committee
on Banking, Trade and Commerce, 27th February 1970.

- 3 -

client, result achieved and ability of the client to pay. In litigation it is impossible to estimate the value of the services rendered until the action and appeals, if any, are completed because the charge depends substantially on the outcome of the action, the amount of money involved, the importance of the issues involved, the result to the client, the wealth or impecuniousity of the client, rather than a mere calculation of the number of hours spent on the matter. The same considerations apply to many other problems encountered by the average practitioner for which no recognized tariff has been established. In matters of this nature it is simply impossible for all practical purposes to establish a dollar value for the services rendered up to any given point.

Some legal firms in Canada do maintain sophisticated docket systems for time expended in all matters but such firms we submit, are in the main large firms operating on a departmentalized system for whom the docket system is indispensable for internal control. For the lawyer or legal firm, such as

McLAUGHLIN, MAY, SOWARD, MORDEN & BALES

The Chairman and Members,
The Standing Senate Committee
on Banking, Trade and Commerce, 27th February 1970.

- 4 -

ours, the greater part of whose gross income is derived from conveyancing and estate work for which a prescribed tariff is in force, the daily recording of letters written, telephone conversations had and registry office attendances performed is not only meaningless but also expensive since it would increase accounting costs by at least fifty per cent. This increased cost would be a burden for all time, long after the transitory tax advantage to the government for one year had been forgotten.

The White Paper suggests that professionals, such as lawyers, have by reason of being "permitted" to operate on a cash basis been "given" "an unwarranted advantage" over the rest of Canadians. We do not intend to engage in a dialogue on such a suggestion that is not only provocative but historically inaccurate except to point out that taxable income of lawyers always becomes assessable, that if some calculated and contrived deferment has occurred by not rendering bills, this has only postponed the tax, and any such postponement can only be from a practical point of view of short duration bearing in mind factors such as the lawyers

McLAUGHLIN, MAY, SOWARD, MORDEN & BALES

The Chairman and Members,
The Standing Senate Committee
on Banking, Trade and Commerce, 27th February 1970.

- 5 -

need of income, reluctance of clients both corporate and personal to be obligated for indefinite periods of time and last but not least the constant changes in legal practices due to death or other partnership dissolutions.

The keeping of the necessary records of time expended, the application of a notional value of such time however impracticable, separating the billed from the unbilled time and making allowances for unbilled and uncollected work are all tasks by no means impossible of fulfillment but at an additional cost out of all proportion to the advantages which will accrue to the Government and, since such additional cost would be productive of neither goods nor services, it must be regarded as an inflationary force.

Respectfully submitted,

McLaughlin May Soward Morden & Bales
per

APPENDIX «H»

NAME: McLAUGHLIN, MAY, SOWARD, MORDEN & BALES

SUBJECT: Cash or Accrual Basis of Computing Income

Analysis of Appendix "G" by Senior Advisor

This brief is submitted by and on behalf of a legal partnership located in Toronto. The brief is limited to comments and criticism of the White Paper proposals restricting the freedom of choice available for reporting professional income on a cash or accrual basis and the requirement to bring "unbilled time" into account.

The brief recommends the retention of the present procedures and concludes with the following comment:

> "The keeping of the necessary records of time expended, the application of a notional value of such time however impracticable, separating the billed from the unbilled time and making allowances for unbilled and uncollected work are all tasks by no means impossible of fulfillment but at an additional cost out of all proportion to the advantages which will accrue to the Government and, since such additional cost would be productive of neither goods nor services, it must be regarded as an inflationary force."

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name : McLAUGHLIN, MAY, SOWARD, MORDEN & BALES

Date Brief Received:

Principal Subject: Cash or Accrual Basis of Computing Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 85F of the Income Tax Act This section permits persons who carry on (1) a profession, or (2) farming to elect to compute income on a cash basis, or to use the accrual basis. Unbilled amounts need not be taken into income if the accrual basis is used.	5.46 Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.	The brief sets out the reasons in favour of maintaining the present choice of alternatives and for not including "unbilled time" in income.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.47 A problem would exist in switching professional taxpayers now on the cash basis over to the new system. This problem relates to their receivables and inventories at the date of the change over. For example, if 1971 is the first year of the new system, the problem would relate to the receivables and inventories as at the end of 1970. These amounts would not have been included in the taxpayer's 1970 income because they would not have been collected at that time. They would not be included in the 1971 income because they were earned before that time. To require that the entire amount be brought into 1971 income would impose an abnormal tax liability in that year. As a consequence, the government proposes that these taxpayers be entitled to bring these amounts into income over a number of years. Specifically, they would bring them into income as their total outstanding receivables and inventories are reduced. This amount would of course be in addition to the amount of their income computed on the accrual basis and would mean that they would be taxed on the greater of a cash-basis income or an accrual-basis income until they catch up to other Canadian businessmen.	

APPENDIX «I»

SALIENT POINTS FROM THE BRIEF SUBMITTED BY JOHN LABATT LIMITED

1. In our calculation of the revenue effects of the White Paper proposals we have shown that the proposed system will yield substantially more revenue than the Minister of Finance has estimated. If this is so, we would suggest that the Minister would be able to consider modifications of the proposals and still collect revenues sufficient for his anticipated needs.

We quote from our brief as follows:

III <u>Impact of the White Paper proposals on "revenues and the economy"</u>

1. Tables 15 and 16 on pages 95 and 96 of the White Paper summarize the Minister of Finance's calculations as to the anticipated effects of the proposals on government revenues, based on what 1969 incomes were estimated to be. Appendix C contains our calculations as to the anticipated revenue effects of the proposals based on a projection of incomes to 1975. The estimates presented are, of course, subject to errors due to averaging and to the particular assumptions employed. We are confident, however, that if anything, the estimates are conservative ones. We should be happy to examine this whole matter with Finance Department officials, as the details of their calculations have not to date been publicly available for scrutiny.

From Appendix C it will be noted that the net revenue effect of the proposals according to our calculations based on 1975 incomes is approximately $1.4 billion as opposed to the $630 million estimat

based on 1969 incomes presented in the White Paper. Such a result is to be expected, as the "fiscal dividend" in times of rising money incomes with a progressive tax-rate structure is one of ever-increasing magnitude.[2] This means that the federal and provincial governments will be collecting $18.5 billion in 1975 as opposed to the $17.1 billion estimated by the Economic Council of Canada in their "Sixth Annual Review: Perspective 1975" -[3] a "fiscal dividend" accruing solely as a result of the White Paper proposals of more than 12%!

All of which leads one to query what the projected expenditure requirements are which will necessitate this increased revenue?

2. Canadian corporations suffer a disadvantage compared with U.S. firms in that they are not allowed to deduct for tax purposes from income earned interest paid on bank loans to finance acquisitions. We would like to see all reasonable costs of doing business deductible for income tax calculation purposes.

---

[2] It should be noted that an individual (married) whose 1969 income was $7,000 and who therefore stands to pay less under the White Paper proposals than under the present system (as do about 1/2 of the 1969 taxpayers) will be earning just over $10,500 in 1975, assuming an average annual increase in his income of 7%. He will therefore be paying more tax than under the present system, as will any married individual earning more than $9,100 or any single individual earning more than $3,400 in 1975. In addition, it is quite possible that by 1975 many of the 750,000 which it is suggested will be removed from the tax rolls as a result of the White Paper proposals will have net taxable incomes and hence be liable for income taxation.

[3] Economic Council of Canada, "Sixth Annual Review: Perspective 1975", page 48, Table 3-9.

We quote from our brief:

a) Under the present system Canadian firms suffer a disadvantage compared with U.S. firms in not being allowed to enter as a cost interest paid on bank borrowings to finance acquisitions. The White Paper proposals compound this situation, making it even more difficult for Canadian firms in competition with U.S. firms to profitably acquire relatively small, efficient Canadian enterprises as a result of the potential non-applicability of the proposed capital gains tax to non-residents.

3. We would hope that the Minister will give further consideration to possible ways in which small business can be accorded some relief.

We quote from our brief:

v) Eliminating the proposal to "phase-out" the preferential (21%) rate on the first $35,000 of corporate profits and instead instituting a "lump sum" system whereby every corporation is allowed a "one-time" total amount of profits in the course of a specified number of years which will be taxable at a preferred rate. Such a sum might, for example, be $200,000 over the course of 6 years. All profits not so designated would be subject to the normal rate of corporate tax.

The Minister would seem to have at least $1.4 billion "to play with" while still meeting the projected revenue requirements estimated by the Economic Council of Canada.

4. While we support the principles of including capital gains in the tax base, we would suggest that the taxation of unrealized gains on legitimate residences and household possessions of individuals is unacceptable.

We quote from our brief:

3. There can be no reasonable objection to the principle of including capital gains in the tax base. Indeed, equity requires that it must be. The proposals of the White Paper to tax one-half of the capital gains on shares of widely-held corporations at the same rate as other forms of income would seem to be acceptable. However, certain other capital gains provisions ought to be carefully considered. The taxation of unrealized capital gains on equity holdings clearly violates the third canon of taxation - "convenience". Individuals and corporations may be placed at a considerable disadvantage with respect to the five-year revaluation provision, and their normal affairs placed in jeopardy as a result. This could, for example, force a Canadian firm to sell a portion of its equity to raise the funds to pay the required capital gains tax, thereby placing in jeopardy its effective ownership, reducing its availability of capital for expansion and possibly resulting in a foreign takeover. Similarly a retired individual subsisting on the proceeds of a portfolio of stock investments, could be required to sell a portion of his holdings to pay a tax on unrealized capital gains, even though his income had not increased. This proposal makes no contribution to equity and may adversely effect the efficient allocation of society's resources and economic growth. No income or increase in actual (realized) purchasing power has taken place. It is true that the individual's wealth has been augmented, but such a tax on wealth penalizes the saving individual and operates to the relative advantage of the spending one. (See Appendix A). There should be no taxation of unrealized capital gains. The proposals relating to the levy of a

capital gains tax on privately owned homes (including farms) and on possessions of any material value represent an intolerable accounting burden (violating the fourth canon of taxation - "cost of collection") and a potentially devious invasion of privacy. To allow a tax-free gain of only $1,000 per annum on a home at a time when price inflation alone adds more than that amount to the value of the average home is unacceptable. Rather than promoting home ownership and a "stake in the community", such a system of taxation would result in precisely the opposite. There should be no taxation of capital gains on the legitimate residences (including farms) and household possessions of individuals.

5. Finally, it is with skepticism that we view the desirability of a piecemeal approach to tax reform. While recognizing the need for adopting a practical approach to comprehensive reform it is impossible to evaluate the acceptability of proposals for partial reform when the ultimate character of the "package" (income tax, sales tax, property tax, excise tax, estate and inheritance tax, etc.) is unknown.

APPENDIX A

		Individual A	Individual B
Year 1	Gross Income	$10,000	$10,000
	Tax (assume rate of 30%)	(3,000)	(3,000)
		$ 7,000	$ 7,000
	Spending	(7,000)	(5,000)
	Savings	-	$ 2,000

B purchases $2,000 of shares of XYZ Inc. with savings.

		Individual A	Individual B
Year 5	Gross Income	$10,000	$10,000
	Capital appreciation unrealized	-	1,000
	Taxable income	$10,000	$11,000
	Tax - 30% of gross income + capital gains tax (1/2 x 1,000 x 30%)	(3,000)	(3,150)
	Net Income	$ 7,000	$ 7,850
	Disposable income	$ 7,000	$ 6,850

APPENDIX C

REVENUE EFFECTS OF PERSONAL INCOME TAX CHANGES

	White Paper Calculations Based on 1969 Incomes Table 15 - Page 95	Our Calculations Based on Projected 1975 Incomes
	Fifth Year ($ millions)	
1. Increased basic exemptions. This includes revenue effect of changes in amount deductible where spouse or dependent has income..................	- 1,000	- 1,387
2. Rate schedule changes.........................	+ 1,255	+ 2,151
3. Employment expense allowance, moving expenses and other deductions for expenses..................	- 235	- 250
4. Child care allowance...........................	- 95	- 100
5. Inclusion in income of unemployment insurance benefits..	+ 85	+ 100
6. Deduction of unemployment insurance premiums paid by employees..................................	- 65	- 75
7. Other items included in income...................	+ 40	+ 50
8. Expense deductions either cancelled or reduced.....	+ 60	+ 70
9. Full reduction of top rates in rate schedule.......	- 40	- 50
10. Inclusion in income of capital gains and deduction of capital losses............................	+ 245	+ 300
11. Deemed realization of gains on widely-held company shares..	+ 100	+ 150
12. Averaging..	- 50	- 60
Sub-total....................................	+ 300	+ 899
13. Effect of integrating personal and corporate income tax..	- 230	- 250
TOTAL..	+ 70	+ 649

APPENDIX C

REVENUE EFFECT OF CORPORATION INCOME TAX CHANGES

	White Paper Calculations Based on 1969 Incomes Table 16 - Page 96	Our Calculations Based on Projected 1975 Incomes
	Fifth Year	
	($ millions)	
1. Reducing the amount of subject to the low rate of corporate income tax	+ 390	+ 500
2. Collecting a tax on dividends received by closely-held corporations from widely-held corporations	+ 60	+ 75
3. Inclusion in income of capital gains and deduction of capital losses	+ 100	+ 150
4. New deduction for "nothings"	- 5	- 5
5. New rules for deducting exploration and development expenditures by companies whose principal business is not mining, petroleum, or gas	- 10	- 10
6. Cancellation of deduction for depletion allowance allowed to non-operators	+ 10	+ 10
7. Cancellation of deduction for club dues, entertainment expenses, conventions, etc	+ 5	+ 5
8. Provisions directed specifically against tax-haven abuses	+ 10	+ 10
TOTAL	+ 560	+ 735

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 18

WEDNESDAY, APRIL 22nd, 1970

Proceedings on the Government White Paper,
entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 18 : 5)

APPENDICES:

"A"—Brief from Shell Canada Limited.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from Liberian Iron Ore Limited.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from McIntyre Porcupine Mines Limited.
"F"—Analysis of Appendix "E" by Senior Advisor.
"G"—Brief from British Insurance Companies.
"H"—Analysis of Appendix "G" by Senior Advisor.

21849—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Leonard
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Preceeding of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technacal, tuled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such councel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21849—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, April 22, 1970.
(24)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*) Aseltine, Beaubien, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Flynn, Everett, Gélinas, Haig, Hollett, Kinley, Lang, Leonard, Macnaughton, Molson and Phillips (*Rigaud*)—(20).

Present, but not of the Committee: The Honourable Senator Laird—(1).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Shell Canada Limited

Mr. H. Bridges, President and Chief Executive Officer;
Mr. R. F. Winfield, Vice President—Finance and Administration;
Mr. W. A. Greenman, General Tax Manager;
Mr. Z. P. Pokrupa, Coordinator-Economics.

At 12:00 Noon the Committee adjourned.

AFTERNOON SITTING

At 1:30 p.m. the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Everett, Gélinas, Haig, Hollett, Kinley, Macnaughton, Martin, Molson and Phillips (*Rigaud*)—(18).

Present, but not of the Committee: The Honourable Senator Laird—(1).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

McIntyre Porcupine Mines Limited

Mr. J. K. Godin, President;
Mr. A. G. Goodeve, Treasurer;
Mr. J. A. Plaxton, Chief Geologist.

Liberian Iron Ore Limited

Mr. B. Unne, Vice-President and Director. (President, Grangesberg American Corp., N.Y.)

Mr. J. Ekman, Vice-President, Stockholms Enskilda Bank, Financial Advisers to Lio.
Secretary-Treasurer, The Liberian American Swedish Minerals Co., (LAMCO).

Mr. N. G. Hornhammar, Tax Counsel, Stockholms Enskilda Bank.

Mr. B. F. Clarke, Q.C., Canadian Counsel.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Shell Canada Limited.
B—Analysis of Appendix "A" by Senior Advisor.
C—Brief from Liberian Iron Ore Limited.
D—Analysis of Appendix "C" by Senior Advisor.
E—Brief from McIntyre Porcupine Mines Limited.
F—Analysis of Appendix "E" by Senior Advisor.
G—Brief from British Insurance Companies.
H—Analysis of Appendix "G" by Senior Advisor.

At 3:50 p.m. the Chairman having to depart the Honourable Senator Phillips (*Rigaud*) assumed the Chair as *Acting Chairman.*

At 4:15 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, April 22, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9.00 a.m. to give consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I call the meeting to order. We have four submissions today and I should tell you that for the convenience of one of them, Liberian Iron Ore Limited, we have fixed the hearing to start at 1.30 p.m. This means that this morning we will endeavour to adjourn at 12 noon so that you may arrange to receive the necessary sustenance to be able to carry on this afternoon.

This morning we start with Shell Canada Limited. Mr. H. Bridges, the President and Chief Executive Officer, is here, with Mr. Winfield, Mr. Greenman and Mr. Pokrupa. Mr. Bridges will open the proceedings with a very brief summary.

Mr. H. Bridges, President and Chief Executive Officer, Shell Canada Limited: Mr. Chairman and honourable senators, may I start by saying how pleased we are to have this opportunity of presenting and discussing our views on the White Paper proposals for tax reform. With me this morning are Robert Winfield, Vice-President, Finance and Administration, Alan Greenman, General Tax Manager, and Peter Pokrupa, Coordinator, Corporate Planning and Economics. My own original discipline, and this was with affiliated companies rather than Shell Canada, was on the exploration and production side of the industry. You will therefore see that only three out of the four witnesses here this morning can claim to be experts on finance and tax matters and in presenting our views and answering your questions, I propose to lean rather heavily on my helpers.

Mr. Chairman, Shell Canada Limited is a fully integrated oil, gas and chemical company which vies with Gulf Oil for second place in the refining and marketing of oil product in Canada. Our sales of refined products amount to about 16 per cent of the total Canadian market. The Royal Dutch/Shell interest in Shell Canada is held through a holding company called Shell Investments Limited and after certain outstanding warrants on Shell Canada shares have been exercised in about two years' time, the effective holding of the Royal Dutch/Shell group will be about 79 per cent. The beneficial holder of the Royal Dutch/Shell shareholding is a Dutch company called Shell Petroleum N.V. which in turn is held on the usual 60-40 shareholding basis by the Dutch and British parents of all Shell Group companies.

If you have had time to study all of the data submitted to you, you may have seen the statistics at the end of the document showing that nearly $1800 million, of which $600 million was a direct investment by the Shell Group and the balance is largely retained earnings, have been invested by Shell Canada over the past 24 years. During this time only $87 million has been remitted as interest and dividends to the Shell Group. These are the kind of figures we wish that some of those people who complain about Canada's birthright being stolen by foreign interests would bear in mind. I might add that in terms of money being spent in exploration for new sources of oil and gas in Canada, we are probably the most active of all companies operating here. Investment incentives, indeed the whole subject of the investment climate in Canada is therefore a matter of paramount importance to us. We make no apologies therefore for holding rather firm views on the White Paper, and we are certainly extremely grateful to the Government for having formulated these in a manner which gives us an opportunity to express these views in advance of legislation being enacted.

Although the existing tax structure has worked well in providing the basic favourable investment climate in which Canada's economy has developed in such a phenomenal way, we in Shell recognize the need for tax reform. Our greatest concern lies with the proposal to introduce a new radical structure as an integrated package with no real hope of predicting the probable economic and equity impact of these changes in advance. We believe that the risk of miscalculation is too great and we therefore believe that the Government should proceed to overhaul the current tax structure.

Shortly I shall be asking our experts to present to you our detailed proposals but may I please summarize some of the main points they will make in the chronological order in which they will make them.

Firstly, in dealing with the individual and the family, the team will give you some details of why we consider the middle income group is to be treated inequitably but there is one point which I would like to make very strongly. At the risk of over-simplification it does seem to us that the overriding message of the White Paper proposals is that in Canada people are to be denied the right which our fathers possessed to acquire a capital sum of money. A pension is in order but capital is to be taxed to virtual extinction. Our current Shell Benefits program gives this right to all employees—and it is the lowest paid worker who will be hit the hardest by the new proposals as compared with the application of the current Section 36. We do ask you most earnestly to examine this aspect.

Moving on to capital gains and corporation shareholder taxation, having accepted the fact that Canada has reached the stage of maturity where a capital gains tax is inevitable, our only concern is that this should not be introduced in such a manner as to drastically alter the current investment climate for growth industries. As pointed out earlier, it is almost impossilbe to forecast the outcome of a "package deal" such as this White Paper proposes, but in Shell we believe that the combination of the quiquennial tax on unrealized gains and the proposed tax integration system would have a very serious effect on our investment capability in Canada. I have chosen the word "capability" with great care because, before one spends money, one has either to earn it, to borrow it or to ask one's shareholders to buy more shares. A little earlier, I mentioned that in the past 24 years the Shell Group has received $87 million in interest and dividend payments. We have made a calculation of the potential impact of the quinquennial tax on unrealized capital gains and if this had been in effect over the past 5 years, the Shell Group would now be liable for an additional tax of $80 million. Would you consider this to be the right kind of deal to hand out to a company which has always, and still does believe in building up its investment base in Canada because it believes that this is "safe" country in which to invest and moreover one which offers opportunities for mutually profitable long-term growth?

In so far as the proposed method of integration for personal taxation is concerned, we believe most strongly that this will discourage investment in growth companies and this will, in the long run, be detrimental to the Canadian economy.

Turning to Chapter V, our experts will shortly be dealing with the White Paper proposals on business and property income in more detail. Here I would like to confine myself to one comment on the subject of depletion allowances. Such a wide variety of possibilities exists that the easiest thing in the world is to criticize any proposal for a percentage depletion allowance. Shell has always opposed the current form of "net" percentage depletion allowance as a disincentive to exploration. To apply the "reductio ad absurdum" principle, it maximized the tax allowance of the owner of a producing mineral property if he did no further exploration whatsoever. The White Paper proposal to relate the incentive solely to expenditures on exploration swings the pendulum too far the other way since it does not sufficiently take into account the long time-span which is involved in the exploration/development/production cycle. We believe that our compromise proposal reconciles these two concerns whilst at the same time avoiding the need for any transitional measures. In this connection, I must make a special plea for the Athabasca Tar Sands. These enormous reserves, more than twice the total reserves of the whole of the Middle East, are almost on the verge of being competitive with conventional sources of crude oil and, compared with their own potentialities for synthetic crudes, must be looked on with a great deal of envy by the United States in view of their own preoccupation with security of supply. At least 75 per cent of these reserves are at depths which preclude mining techniques so that development would presumably fall

under the legislation for oil and gas rather than minerals. Even if this were not the case, the White Paper now proposes to alter the tax rules for mining ventures which will considerably reduce the incentive for an Athabascan venture. Eighteen months ago, Shell voluntarily gave up a preferred position for a permit to develop a project in these tar sands partly because of what is considered to be the almost impossible conditions proposed by Alberta for the sale of the resulting synthetic oil, but also because of a real fear that the economics of such a project might become unfavourable during its construction period. To be specific, at today's costs and today's prices of synthetic crudes it is possible to produce an evaluation which makes a project look viable. If we assume that costs will escalate annually at 4 per cent to 5 per cent but that the value of synthetic crude will only escalate at, say, 1 per cent per annum, the project begins to look pretty unhealthy. If we add to all of this the White Paper removal of the percentage depletion allowance on oil produced—because in the Tar Sands, exploration costs are relatively small—such a project, in our opinion, is dead. And yet some day North America is going to need Athabasca. If need be, I recommend to you that the Government of Canada work out special rules for this kind of development, without trying to bring them into the orbit of the normal oil and gas operations of this country.

Gentlemen, I hope I haven't exhausted your patience with this introductory speech. I am now going to ask our experts to take over and explain our proposals in detail.

Mr. R. F. Winfield, Vice-President, Finance and Administration, Shell Canada Limited: Mr. Chairman, with your permission I should like to comment very briefly on each chapter in the Shell brief and, before leaving that chapter and going on to the next, to ask you if you have any questions. May I now please direct your attention to chapter 2, which is entitled "The Individual and the Family in Tax Reform".

Shell believes that the prime purpose of the rate schedule should be to serve the taxing of earned income fairly; that is, for those who do not have any capital gains tax and no dividends. In our view the White Paper schedule is distorted by the assumption that the weight of capital gains is going to fall on the higher income groups. I believe the experience in the United States is that this is not the case, and that the main burden of capital gains falls on the middle income group.

Secondly, the White Paper schedule is distorted by mechanical and revenue constraints of the integration scheme, and the effect is to compress both ends of the schedule and cause a bulge in the middle and impose a disproportionate tax on the middle income group.

We feel that Canada, and certainly Shell, needs this younger generation, and in the brief we show two examples of the impact of tax. In the left-hand column you will see the impact of Canadian versus United States tax on an individual in 1970 on a level of salary which is $15,000 Canadian.

The Chairman: Is this on the basis that the White Paper proposals have been implemented?

Mr. Winfield: No, this is the present form, Mr. Chairman. And there you will see that what I want to point out is that already there is a large discrepancy in favour of the United States for a man earning $15,000. We have tried to keep these as simple as possible, by assuming a married employee, with two children under 16, only standard deductions, no state taxes and no provincial taxes over 28 per cent and the U.S. social security tax as income tax. If you look at the second column, the middle column headed "White Paper Proposals", you will see the divergence widens even further and that at the marginal rate, the Canadian employee would pay 69 per cent more than his United States counterpart, and at that point the respective marginal rates would in Canada be 38.4 per cent and in the United States 22 per cent.

Senator Molson: Mr. Chairman, leaving out the state taxes may cause some to say that the example is not fair, but I think because it is compared with the present law and the White Paper proposals that the relevant figures here would still be accurate, would they not?

Mr. Winfield: I think they are a fair comparison on that basis, yes.

Senator Molson: We have already had the suggestion that the moment we compare Canada and the United States and don't take state taxes into account, it becomes an invalid comparison.

The Chairman: Yes, if you are taking in provincial taxes for the Canadians.

Mr. Winfield: Not above the 28 per cent.

The Chairman: Yes. Is there anything further on that point in view of Senator Molson's question?

Senator Phillips (Rigaud): Yes, Mr. Chairman. In the recommendation on the White Paper proposals, there is a reference to the phrase "middle-income group" in the last paragraph. Have I overlooked anywhere your reference to a definition of what you would regard as the middle-income group in terms of dollars?

Mr. Winfield: I would think, Senator Phillips, that we are looking at the $10,000 to $15,000 levels.

Senator Phillips (Rigaud): Would you regard over $15,000 as being in the middle income group?

Mr. Winfield: I think one has to stretch the point a bit there. Possibly the parameters of the definition could be widened, but I think the point I want to make is that as a result of these constraints that have been built into the rate schedule, both ends have been compressed so that there is in effect a large bump on the middle of the schedule. Now the main point of the bump or the height of the bump, I suppose, is around the $15,000 mark.

Senator Phillips (Rigaud): There is a general feeling in Canada that the hard core of those who are saving are those who go up to $25,000.

Mr. Winfield: Senator, I think the point of what we are trying to make here is that it is the young person of say 20 to 30 years of age, the graduate, who would be tempted, instead of working in Canada, to go south of the border. This is a man who we feel will be earning this $15,000.

The Chairman: What you are talking about is those in the middle income group in the area between $10,000 and $15,000. You are not talking about the middle income group so much as about a specific type of person. You are not being exclusive in your definition of the middle income group?

Mr. Winfield: No.

Senator Phillips (Rigaud): You are dealing with a problem which is clearly reflected in this brief. In what category would you put those incomes from the point of view of those who save most in relation to their gross income?

Mr. Z. P. Pokrupa, Coordinator Corporate Planning and Economics, Shell Canada Limited: I do not think we have made any studies on this.

Senator Phillips (Rigaud): Would you like to express an opinion on that? We are trying to reach in this committee some consensus as to the group that saves most and hence in the process do most for the country in the final analysis.

Mr. Pokrupa: Obviously it would have to be those who have first of all provided for their necessities or their initial establishment in society. That is to say that over $15,000 is the group I think that is the savings group.

Senator Phillips (Rigaud): How far would you go as an across-the-board concept of those in Canada who do the saving? Would you go as far as $25,000 or is that too high?

Mr. Pokrupa: I think it is not too high.

The Chairman: Well, if it is not too high, you must have something in the back of your mind for saying that. How high is not too high?

Mr. Pokrupa: As I say, we have not made any study of this, and this is an opinion based on observation and I would say that any limit can be imposed.

The Chairman: But in the savings group, a man earning $40,000 a year—would not you regard him as being a saver?

Mr. Pokrupa: We do, and I think we have to look at the propensity to save, and the propensity to save increased amounts after providing for necessities. If it is a case of the professional in the group, I would say that $15,000 has to be provided for necessities. After this his propensity to save is increasing and therefore he is becoming a saver or investor. Now where the limit is, I don't know.

The Chairman: Going up from the $15,000, is there any stage in his earning power above $15,000 where somebody is ordinarily likely to cease to be a saver?

Mr. Pokrupa: I don't think so.

The Chairman: You would say that the whole area above $15,000 encompasses what might be described as the savers?

Mr. Pokrupa: I consider this to be a fair statement.

Mr. Winfield: Now, going on to the next page, we find that it deals with the income averaging proposals of the White Paper. May I talk for a moment about the general aspects of these income averaging groups. I think Shell considers them as modest, and modest for the purpose of smoothing the bulges in ordinary income, and we do not think that by any stretch of the imagination they can be regarded as fair for application to capital gains that have accrued over many years or to retirement savings which may be the accumulation of a lifetime of work.

The Chairman: Would you in a very summary way just show us what the present situation is and how this will be changed under the White Paper proposals?

Mr. Winfield: On capital gains, Mr. Chairman—of course, we have no capital gains at the present time—the proposal under the White Paper is that capital gains should come into income and should be treated as income. As far as lump sums received from employees on retirement savings programs—and I have an example of that—we have particular concern about this question. The present system is far from generous. It provides that you can apply the average rate of tax over the last three years of your career to a certain proportion of your retirement savings.

Now, this is likely to be a high rate at the end of a man's career compared to the beginning, and it compares unfavourably therefore with the rate that he has been contributing to the scheme early in his career. The effect of this, as we see it, is to remove to a large extent some of the benefits of tax deferment. We have some examples in the brief in the left-hand column and you will notice that we have the actual case of a Shell employee, a mechanic in one of our refineries who is at the $9,000 income level. He is retiring in 1970 and is withdrawing $27,000 from his Shell retirement savings plan. The amount withdrawn is $27,000. The average tax rate for the last three years for this individual was 17.54 per cent, and the tax payable at the moment, under section 36, is $4,735.

The White Paper proposals are shown on the next column, exactly the same man, the same salary, the same amount to be withdrawn, and you will notice that the tax goes up to $10,224, which we regard as punitive.

Senator Laird: Have you informed your employees of this situation?

Mr. Winfield: No, sir.

Senator Laird: One other company that appeared before us, if I recall correctly, did, in writing.

Mr. Winfield: Well, what we have done with our employees is to tell them that we are making representations to committees like yours and to the Minister of Finance to ask him to be less harsh.

Senator Laird: How about having them make representations too? They can.

Mr. Winfield: It is an idea, sir.

Mr. Bridges: It is one of the things we thought of but deliberately avoided. We did not want to get the reputation of being an outfit which tried to stimulate all its employees to get into a campaign against something like this. We felt we ought to do it for them.

Senator Laird: They may need some stimulation.

The Chairman: Not with this differential; I would not think they need any stimulation.

Senator Everett: I wonder if you happen to have the mathematical calculations that allow you to arrive at these figures?

Mr. Winfield: Yes, I think we have. Would you like me to give them now, or give them to the adviser?

Senator Everett: If the Chairman has no objection, I would like the witness to run through them very quickly now.

Mr. Winfield: I am sorry, but we do not appear to have them with us.

Senator Everett: That is fine. As I understand it, . . .

The Chairman: Just a minute. Will you undertake to send them in to us as quickly as you can?

Mr. Winfield: Yes.

Senator Everett: Perhaps you could explain this. In the present system you have taken the average rate of tax over the last three years?

Mr. Winfield: That is right.

Senator Everett: Which is, I assume, the taxable income or the tax paid as a percentage of taxable income.

Mr. Winfield: Yes, that is right, and you take the average of that.

Senator Everett: So that would be considerably lower than his marginal rate?

Mr. Winfield: It is 17 per cent in this particular example.

Senator Everett: Perhaps you could define for me the difference in calculating the same amount, without giving figures?

The Chairman: What do you mean, Senator Everett, by "this average would be lower than his marginal rate"?

Senator Everett: His marginal rate in the last year might be 35 per cent, for example, but his average rate, being the product which is a percentage of the tax paid to taxable income, would be very much lower.

The Chairman: I can tell you that we can get into this because I am now advised they have found the figures.

Senator Everett: Fine.

Mr. W. A. Greenman, General Tax Manager, Shell Canada Limited: Are you familiar with the section 36 calculation, senator, or is that what you wish me to explain?

Senator Everett: I think the section 36 calculation is fairly simple. I am really more interested in how you arrive at the White Paper averaging.

Mr. Greenman: If section 36 were withdrawn, if you were to put the $27,000 in as ordinary income on top of the $9,000, you would arrive at a tax of $12,097. The next step was to implement the general averaging system, which would be your privilege, and here the average income of the past four years would be converted to a threshold amount by adding one-third to that average income and, according to my figures, it would produce a threshold amount of $11,687.

Senator Everett: That is taking the $9,000 for the three years and the $36,000 for one year?

Mr. Greenman: Yes. The reason for the figure is that we have been very accurate. We have taken the Canada pension contribution as a deduction in computing income, and also the $150 proposed by the White Paper as an employee allowance. That is the reason for the figure of income of $8,765.40. That is the average income we are talking about, and adding one-third to that the threshhold amount then is $11,687.

Senator Everett: So you take just the three years preceding?

Mr. Greenman: The four years.

Senator Everett: The four years preceding the gain?

Mr. Greenman: Yes.

Senator Everett: But you do not take the gain into account?

Mr. Greenman: No, sir. You first have to compute the average income of the preceding years and increase it by one-third. The income of the year in which the $27,000 is withdrawn is $35,765; and we take away the threshhold of $11,687 to arrive at the excess in that year, which is $24,078.

The next step is to divide that excess by five and add one-fifth of that excess to the threshhold amount. This is the complicated formula provided by the White Paper.

Then you proceed to compute the tax on one-fifth of the excess, multiply it by five, and, as the White Paper says, you have really widened the bracket to five times its normal width, which is what the averaging is all about.

Through this, following the White Paper procedure which is illustrated in the White Paper, you arrive at this figure of $10,224 as being the tax on the $27,000.

Senator Everett: So the employee decides as an alternative not to retire then?

Mr. Winfield: Or to take out pension, of course. He can escape tax by converting his retirement savings into pension.

The Chairman: Or you can provide each employee with an accountant!

Senator Beaubien: In the last year, Mr. Winfield, would he not take his $27,000 in the year when he did not earn any income? Could he take it out in the year in which he was getting $9,000?

Mr. Winfield: Senator, the scheme provides that he withdraws his provident fund on retirement; he has no choice.

Senator Beaubien: He could not retire at the end of the year and get the $27,000 in the year in which he earned nothing?

The Chairman: Do you mean if he did not become entitled to the $27,000 until the year following his retirement?

Mr. Winfield: Yes.

Senator Beaubien: Because we are talking of income of $36,000 in the last year, but if $27,000 is put off until the following year...

Mr. Winfield: This could be a possibility, but I think the taxing authority would look at the rules of the scheme and deem him to have received $27,000 on retirement, and that is his income for that year. It is quite possible, however, that we are going to have to change our scheme if this sort of legislation is passed.

Senator Everett: But is it not true that even if the taxpayer were allowed to withdraw by the method that Senator Beaubien suggests, the White Paper recommendations will militate against him?

Mr. Winfield: Oh, yes.

Senator Everett: Is there anything to preclude an employee from deferring his withdrawal?

Mr. Winfield: Yes, there is. Under the rules of the Shell Retirement Savings scheme it is provided that he withdraws his lump sum when he retires. It is part of the rules. And you have to register these schemes with the taxing authority.

Senator Carter: But he could convert that if he wished?

Mr. Winfield: Yes, to a pension, and if he converted it into a pension he would not then be subject to the section 36 rule. There would be no tax on the capital, but he would be taxed as he received the pension.

The Chairman: But if he followed Senator Everett's and Senator Beaubien's proposal, with the payment of the $27,000 falling into the next year the man would in that year have at least $27,000 of income, and he would not have the benefit of the averaging provision, because this would be something that accrues after retirement and not at retirement. He would pay whatever the new rate proposed in the White Paper is on $27,000.

Mr. Greenman: Under the White Paper he would have the averaging system available to him, and he would also have the ordinary pension income provision available to him.

The Chairman: Perhaps this is a good place at which to interject Mr. Gilmour.

Mr. Arthur W. Gilmour, Senior Tax Adviser: Gentlemen, I have not been engaged in the Quebec elections or anything like that, but I apologize for my voice.

Under our present tax laws, when a man reaches retirement, or where he has rights in a fund and perhaps withdraws from his employment, or fate withdraws him by intervening death, then there are two options really open to him. First, if the terms of the pension plan permit it, he could simply take the payment and draw it as income in the year in which he gets it, with no averaging. In other words, he could just treat it as income. Sometimes, where death has intervened, that is the better method of handling it. But even if a man has been in full stride, having reached perhaps his maximum earning capacity and then retires, then obviously he does not gain anything by adding the special payment out of the pension plan on top of his basic income because he would be subject to increased graduated tax rates, and literally his whole life savings would be taken from him.

Section 36, which has been in the Income Tax Act for many years, gives him the right to take this special payment, segregate it from his regular income, and pay tax thereon at the average rate at which he paid tax in the previous three years. Now, that is not too much of a benefit, because if you have a man whose income has been approaching its peak, his average over the previous three years obviously is going up, so that the tax he pays on the lump sum that he gets is obviously going to be very high. We have been forced to live with that for a long time.

The United States, faced with a somewhat similar problem, takes these lump sum payments and says that they shall be the equivalent of a long term capital gain; they are segregated completely from income, and subjected to what used to be a flat rate of 25 per cent. It is rather interesting to note that the tax in the example given by these gentlemen, namely, a payment withdrawal of $27,000, under our present law works out awfully close to the American rate of 25 per cent.

In the proposal in the White Paper we have a most complicated scheme of averaging. This is spelled out in paragraph 2.56 of the White Paper. The conditions for averaging are very limited. This paragraph says that when your income in the taxation year which, presumably, is the year of retirement—when your

income in the year of retirement exceeds your average income of the preceding four years by more than one-third, then you can average. In other words, you cannot average unless you meet this requirement that your income in the year of retirement has jumped by more than one-third.

This may be fine in the case of a professional athlete or somebody like that whose income can leap by a substantial amount, but when we consider the average mechanic working for Shell who retires, we realize there are going to be mighty few people in that category who will have an income greater by one-third than the income of the previous four years. So, the averaging proposal is a pretty meaningless proposal for most Canadians, and it certainly is not adequate.

The Chairman: Are there any questions? If not, will you proceed, Mr. Winfield?

Mr. Winfield: Mr. Chairman, I should like to draw your attention to the retroactivity features inherent in the White Paper proposal. When a man has been saving under an approved set of tax rules for 20 years in order to develope a reasonable financial scheme for his retirement, we think it little short of iniquitous that the Government should turn around and say to him: "Sorry, chum, you may have thought you were working under these rules for 20 years, but you are wrong. We are now going to change them from the beginning." This is, in effect, what the White Paper does.

We, in Shell, suggest two things. We suggest that section 36 and section 85A—which is the one that applies for averaging purposes to stock options—should be retained, or hopefully some better substitute developed therefore. I have pointed out to you that we do not think they are very generous as they stand today. If the Government is not prepared to do this then at least it should allow those members of our retirement savings program who have had ten years' service, and who are 45 years of age, to withdraw their lump sums in the future under the present rules on the ground that they have probably gone beyond the point where they can replan the financial aspects of their retirement.

I suppose, finally, what we would prefer is what Mr. Gilmour has suggested, namely, a capital gains treatment, if we can get a reasonable one.

Mr. Chairman, that is all I have to say on chapter 2.

The Chairman: We proceed, then, to chapter 3.

Mr. Winfield: Chapter 3 deals with capital gains as income, and I think Shell would like to make three main points. First of all, we feel that there should be a separate, realistic capital gains tax. Secondly, we feel that under no circumstances whatsoever should any unrealized gains be taxed. Thirdly, we feel there should be introduced what we call a roll-over provision to encourage the reinvestment of capital gains, and payment of the tax at death on realized gains only.

Let me talk first about a separate tax concept. It is obvious that capital gains occur over many years. Surely it is inequitable to tax them, as the White Paper proposes, at the marginal rate of the taxpayer when these gains are realized. There is an inflation element in capital gains so that by taxing under the White Paper proposals there is a tax on capital as such. Finally, we really do not see the sense of imposing in Canada a greater penalty on capital formation and initiative than is imposed by our neighbours to the south. The question, of course, then is how do you develop a rate schedule for the separate capital gains tax that we propose to cover all these points? We merely suggest a simplified approach of taking half the gain into income and taxing it at a maximum of 25 per cent.

The Chairman: You make no distinction by that method between what I call the transaction for the fast buck and what is investment?

Mr. Winfield: Most definitely so. I was going on to say, Mr. Chairman, that this tax would apply to long term capital gains and that, in effect, we would propose that speculative gains, which might be how you would describe what you are referring to, would be subject to full income tax.

Senator Laird: Are they not subject now under existing law?

Mr. Winfield: Not in the existing law, senator.

Senator Laird: Mr. Gilmour is nodding his head.

Senator Phillips (Rigaud): That is based on administrative decision rather than the statute.

The Chairman: Whatever the statute might say, it is quite clear from the decided cases

that the expression venture in the nature of trade or carrying on business has been applied to many, many stock transactions on the basis that they did not have an investment characteristic. So it is on the present law based on decided cases.

Senator Phillips (Rigaud): I am giving my wholehearted support to the suggestion and I am delighted with your brief. Have you given any consideration to the elimination of certain types of capital gains in respect to which there would be no tax at all, or at least a reduced tax? I am referring to homes, farms, house contents, personal effects, and the like. I know that you have assumed that the capital gain on the capital would be applicable to capital gains on all capital investment.

The Chairman: Rather than limit it to shares?

Senator Phillips (Rigaud): That would be polarizing it.

Mr. Winfield: I have to answer the question this way, that we do consider that there are many types of capital gain which should not be subject to tax. However, in preparing this brief Shell has been very careful not to comment on anything unless we could offer a reasonable, specific alternative. We really have not had time to think about the problems of capital gain on housing, farms and land. It is a complex subject to develop a reasonable alternative except by complete exclusion.

Senator Phillips (Rigaud): If there were such exclusions within reasonable limits, would you regard that as desirable?

Mr. Winfield: Most definitely, sir.

The Chairman: With respect to capital gains on property, land transactions, under the present law as reflected in the decided cases, practically the only type of real estate transaction that escapes tax today relates to the sale of the principal residence, or to a homestead property. If you consult the decided cases you will find it difficult to draw any other conclusion. You will also find very few cases other than sales of principal residences and homesteads where the gain has not been made subject to tax. Therefore we could leave that state of the law alone, having regard to the view that you have expressed.

Mr. Winfield: Yes, but I think that had we had time to work out a reasonable alternative we would certainly have done so for principal residences.

The Chairman: You mean other than simply saying that they should not attract tax by sale?

Mr. Winfield: Yes, other than saying they should just not attract tax. We think that the $1,000 is probably a wrong figure, but we had difficulty in coming up with a counter proposal which could be applied not only to the simple case of principal residence but to the more complicated case of farms. Therefore I do not wish to leave you with the impression that we like the White Paper proposals on principal residences. I just want to observe that the 25 per cent rate we suggest has the virtue of simplicity and, of course, parity with the United States.

Senator Everett: Can you tell me whether capital losses would be deductible against capital gains in your system, or against income generally?

Mr. Winfield: One would have to differentiate between capital losses on long term gains and capital losses on speculative gains. On long term gains we had anticipated that the loss would be offset against the long term again and if this were not sufficient, against income. On the short, speculative type of gain there would have to be some restriction to protect the Government from someone who was speculating widely and could develop a large loss possibly offsetting it against income. Therefore, one would be thinking of the speculative losses set off against speculative gains maybe, then against capital gains, then perhaps against income, but with a limit of, for instance, $1,000 a year.

Senator Everett: That takes care of speculative gains. Then you say in the long term gains they would be offset against long term profits.

The Chairman: A long term loss would be offset against long term gains.

Senator Everett: Yes, long term profits or gains, but if those gains were not sufficient to offset, then it could be offset against general income?

Mr. Greenman: Yes. The U.S. system, of course, requires the short term losses to be applied against short term gains, and long term losses against long term gains. Then any excess in the year in one category or the

other to be offset one against the other. If you end up that year with a loss after all the cancellations, only $1,000 can be applied in that year against ordinary income. That comprises both long term losses and short term losses. So they are quite restrictive. We had considered recommending such a procedure, because it seems to work well. However, we were aware that the White Paper presumably contemplates that all losses would be deductible against ordinary income. We did not wish to be more restrictive in that regard in respect of long term losses than was the White Paper itself. It would be no problem, I presume, for the Finance Depar'ment to work out the proper procedure for their own protection against losses.

Senator Everett: Indeed.

Mr. Winfield: Perhaps I could go to the last point we make on this subject, which is the proposal that there should be a roll-over provision, whereby if realized gains from widely held corporation shares are reinvested in widely held corporation shares they should not be subject to tax except on death. This, in our view, has the benefit of encouraging reinvestment by Canadians in the country. It avoids this locked in condition that the White Paper criticizes. We feel it is quite reasonable that the tax on these rolled-over realized gains should be paid at death, subject to giving the trustee of the estate the option to revalue the whole of the security portfolio.

Senator Phillips (Rigaud): I for one regard this objection as most intriguing and creative, and with considerable sex appeal one might say. However, I should like to put one question to you, because I think the general conception of tying in capital gains tax with a procedure which will enable Canadians to retain their capital is attractive. This committee has heard from many taxpayers about the distinction between shares in widely held corporations as distinguished from those in privately held corporations. Broadly speaking, I think that most of the representations make the point that no such distinction should be made, that it is neither philosophically, economically nor otherwise desirable or justified.

I was wondering, (a) why you came to the conclusion that this roll-over provision should apply only to widely held corporations; and (b) whether you have given consideration to the point that the right to roll over should be restricted to a number of roll overs? With a young investor, the Crown may be very impatient, awaiting death in order to cash in on the incidence of tax.

The Chairman: That is not putting the premium in the right place.

Senator Phillips (Rigaud): Or the taxpayer may not be in Canada at the time of demise.

Mr. Greenman: Perhaps I might answer that. Our reference to widely held shares being the subject of the roll-over was perhaps due to the fact that we had an eye to the kind of annual reporting that would be required by every taxpayer. That involves a reasonably extensive procedure for setting down his stockholdings at the end of the year, a reporting of his gains and losses during the year and a reporting of what he has reinvested of his gains. In other words, if his new holdings at the end of the current year were equal to his holdings of the preceding year, plus any gains he had made in the year, his gain would be rolled over. We therefore worked out this kind of example, and felt that it would make a difficult audit and reporting problem if we were including the shares of private companies and small companies. At least the audit department of National Revenue would with widely held shares have a fair chance of verifying the cost. This sort of accounting and reporting problem was more in our minds than anything else, keeping a check on the whole procedure.

Senator Phillips (Rigaud): What about the second point, whether you gave consideration to a restricted number of roll-overs?

Mr. Greenman: No, we gave no consideration to that. I suppose our theory here was that a person who does not realize a gain can generally speaking defer it for a lifetime.

Senator Phillips (Rigaud): You figure you catch up with it at death?

Mr. Greenman: Yes, certainly there must be a catching up at death, as you say.

The Chairman: Mr. Winfield, I notice you have not dealt specifically, although you have in your brief, with the proposal to tax unrealized gains. I presume it is inherent in the emphasis you have put on the other elements you discussed in this context about realized gains that you are against unrealized gains being taxed?

Mr. Winfield: Yes, most definitely. Shell feels that all unrealized gains should not be taxed—any unrealized gains. The very phrase

is a contradiction in terms. How can you have a gain if it is not realized? We feel that even on leaving the country unrealized gains should not be taxed.

Senator Everett: As I understand it, you would include in income at the time of death the previous rolled over profits. That is, a man would accumulate his profit at the time of roll over throughout his life, and that would be brought in at the time of his death.

Mr. Winfield: That is right.

Senator Everett: Indeed, if he did not roll over, on the portion of his portfolio that he did not roll over there would be no need to include this?

Mr. Winfield: No, because if he had realized any profits on his stock transactions and had not reinvested them...

Senator Everett: I was not talking about them. I was talking about the ones which he had not.

Mr. Winfield: That he had not moved?

Senator Everett: That is right.

Mr. Winfield: No, there would be no question of revaluation, because the White Paper suggests that at death the unrealized profits should not be taxed but should be accepted by the heirs at the cost to the deceased.

Senator Everett: What happens to the value of the man's estate in respect of the roll-over profits that are brought into income?

Mr. Winfield: We give the trustee the option...

Senator Everett: I am not talking about the option. Let us assume the trustee does not take the option, but just takes tax on the roll-over gains during the man's lifetime. What happens to the value of his estate as a result of taking those roll-over gains into income?

Mr. Winfield: Do I understand you to say that he has paid tax during his lifetime?

Senator Everett: No, he has not, but under the proposal he will have to pay tax.

Mr. Winfield: The trustee, we feel, would have to realize some of his stocks to pay the tax. We think this is a reasonable situation. These, we suggest, should be confined at this stage to widely held shares, so we do not think the trustee should have too much difficulty in realizing some of these shares to pay the tax on the realized roll-over gains.

Senator Everett: I assume that it would be a reduction of his estate.

Mr. Winfield: Hopefully, but there are no proposals in the White Paper to integrate capital gains to estate taxes.

Senator Everett: I am talking about your proposal.

Mr. Winfield: Yes, but we have not gone far enough to look at the estate taxes. The hope would be that there would be an integration in our scheme with estate taxes.

Senator Everett: Thank you.

Senator Phillips (Rigaud): I take it that with respect to taxation at death that you are assuming that a tax is exigible because under recent legislation if the entire estate went to the wife or to a consort there would be no tax exigible. I am assuming by your suggestion that you are thinking of the tax being payable when a tax is exigible.

Mr. Winfield: Definitely.

Senator Everett: Let us assume that the man leaves his estate to his wife. The tax you are suggesting is an income tax.

Mr. Winfield: That is right.

Senator Everett: Therefore the tax would be exigible on the roll-over gains at that time even though there is no tax on the devolution to his wife.

Mr. Winfield: This is income tax.

The Chairman: There may not be a deferred liability of income tax for the estate. Possibly we should have a word from Mr. Gilmour on this point—one of those nutshell comments.

Mr. Gilmour: Gentlemen, under the White Paper, as it exists today in the event of death if the trustee or executor sells to a third party assets of the deceased then that becomes a taxable transaction. On the other hand if the executor distributes to a beneficiary then there is—I am not quite sure what the roll-over is.

Senator Burchill: Thank you.

Mr. Gilmour: That makes two of us. The White Paper proposes that there shall be no

tax paid on the unrealized gain, but rather the beneficiary, the widow is deemed to have a lower cost to the asset left to her. The lower cost is based on the original cost to the deceased.

The estate, if it goes to a widow or beneficiary, passes intact so far as tax on capital gains is concerned and then ultimately if the widow sells any of the inherited assets then of course there will be a realization at that stage of the difference between the proceeds of sale received by the widow minus the cost of those assets to the deceased. On that particular point there seems to be a reasonable fairness in providing for the case where the assets go to a beneficiary. Of course, it has to be because this committee at great length a year ago dealt with the vastly increased estate taxes, the proposal that sums going to a widow would escape tax or the estate tax would be deferred in such a case. In effect the capital gains situation is proposed somewhat in the same way.

I think it might be very important, no matter what form of gains tax, if any, we are faced with, that there be some such provision to see to it that the estate is not impoverished by a capital gains tax at the date of death.

Senator Carter: Would the difference between the proceeds of the sale and the cost of the assets which are sold be added to the value of the estate or would that be income for the widow?

Mr. Gilmour: It would be the unrealized value or the profit which would fall into the value of the assets of the estate for estate tax purposes. Of course, if there be solely a widow as a beneficiary that does not matter because there is no estate tax payable. If this were going to sons, daughters, nieces and nephews then, of course, the unrealized profit would be valued in the present way. You value assets of an estate at the death and then whatever succession duty taxes or estate taxes that may be applicable are payable by the estate itself or by the beneficiaries. That procedure would follow, but as you know, as far back as October, 1968, revision was made that money left to a widow will escape taxation until death of the widow. That means that she can be provided for. When the other beneficiaries inherit they get clobbered seriously under our present law. I think that the authors of the White Paper at least were reasonably consistent in their proposal in the event of death. That is one of the few favourable things I am able to say.

The Chairman: We noted that, Mr. Gilmour.

Senator Hollett: Mr. Gilmour said that he is not quite sure what a roll-over is. We all know what a roll-over is in certain circumstances. What is a roll-over? Would somebody describe it in a few words?

The Chairman: Mr. Winfield, we will give you first chance since you have made use of it in your brief. What is your concept of a roll-over?

Mr. Winfield: I think what we have in mind here is that...

Senator Hollett: You only think that?

The Chairman: The meaning he is giving to it.

Mr. Winfield: What we have in mind here, if I could give you an example, is if you have an investment of a hundred dollars and you make ten dollars on it, under the White Paper this would be subject to a capital gains tax and it would be brought into income and you would pay tax on it at the normal income rates.

The Chairman: On the ten dollars?

Mr. Winfield: On the ten dollars. We are suggesting that there should be a separate capital gains tax. If you just pocket this ten dollars profit you have made then we are suggesting that it should be taxed separately at 25 per cent. However, to encourage you to invest that money in other stocks we would have the law provide that if you do re-invest the money then you need not pay your 25 per cent capital gains tax on that profit and that you defer it, you roll it over until you die and at that point you add all of these realized gains you have made over your lifetime. Your trustee looks at your whole portfolio, revalues it and pays a capital gains tax of 25 per cent on the accumulated realized gains which you have deferred or rolled-over.

Senator Hollett: It is better to spend it when you get it.

The Chairman: Then you know where you are.

Senator Connolly (Ottawa West): Surely it follows what the White Paper has said that the onus is upon a trustee of an estate to review the portfolio of a deceased over his lifetime and to determine what capital gains or losses he has made. This is virtually an

intolerable burden. I would suggest to you, sir, that except for the most meticulous kind of investors, the average person who has, say, an income from investments, does not really keep records as carefully as that. Is it not going to be virtually impossible for them? Would it not be virtually impossible for a law-abiding person to do that?

Mr. Winfield: Under the White Paper proposals you have to make returns of all your capital transactions and all we are suggesting here is a slight expansion of the detail that the law will require you to keep on your tax returns every year.

Senator Connolly (Ottawa West): Perhaps the answer to my question lies in this, that your system would come into effect only if some of the proposals of the White Paper would come into effect and from then on the capital gains record would have to be kept.

Mr. Winfield: Yes.

The Chairman: Chapter 4.

Mr. Winfield: Chapter 4, corporations and their shareholders. This is probably the most difficult of the chapters to deal with. Shell does not believe that the integration proposals are required to remove the so-called burden of double taxation; nor does the White Paper itself; nor did Mr. Carter; nor does the United Kingdom, which abandoned the system of integration in 1965; nor does the United States, which abandoned the system of dividend tax credit in 1965 as well.

We subscribe to the view that, while there may be double taxation of corporate source income in the mechanical sense of two forms of taxes, there is no burden of double taxation on the shareholder. This is because corporations regard corporate taxes as the cost of doing business and they ordinarily pass these costs on to their customers in the form of higher prices or to their suppliers in the form of paying less for goods and services, and so achieve an equilibrium in their share prices to reflect the absorption of these costs. Where competitive forces have prevented total shifting, the prices of corporate shares will have fallen to a new equilibrium point where new investors achieve a normal return on their investment.

If this is the case, and we believe it to be so, then dividends should be recognized as just one other form of personal income to be taxed in shareholders' hands. I am speaking now of widely held corporations and large closely held corporations and I shall come back to comment later on the relationship between these two, and I will come back in a moment to the question of small corporations.

Shell, in view of these factors, recommends a separate non-creditable corporate tax and the imposition of a separate flat tax on dividends.

The question is how, and at what rate. The present system, as you know, provides for a 20 per cent dividend tax credit and this applies at each layer of the taxpayer's income. In other words, as the dividends flow in to the rate schedule which is applicable to a taxpayer, 20 per cent is credited at each layer. The effect of this is that the higher the proportion of dividends in a taxpayer's income, the lower the rate of tax on those dividends.

We have some examples of this. If you would be kind enough to look at the brief, on the left hand side, we show an example under the present law, where a taxpayer with a sole income consisting of dividends of $12,000 has a tax of $134. The White Paper widens this inequity further and you notice that the same taxpayer with $12,000 of dividend income only, gets a refund of $1,142 and in effect can earn as much as $18,276 in dividend income and pay no tax at all.

Shell is proposing a 15 per cent rate and the effect of this is shown in the red column. You notice that the effect of the 15 per cent dividend flat tax is to impose a reasonable burden of tax on the dividend incomes of $12,000 and $18,000. We suggest that the 15 per cent flat rate is much less administratively costly than the proposals for integration under the White Paper and if necessary could be withheld at the source.

The most dangerous aspect, however, of this whole integration proposal, as far as Shell is concerned, is this problem of creditable tax. That is to say, the relief on dividends in the shareholders' hands is restricted to the amount of tax that the corporation has actually paid. The effect, of course, is twofold. First of all, the Canadian investor will look to invest in mature corporations with a maximum creditable tax positions and will stay away from the growth stocks, growth shares, where the creditable tax is small, because of capital cost allowances, depletion, incentive allowances and the like. Foreign buyers, who

are not to be given the privilege of this creditable tax, under the White Paper proposals, will buy these growth industry shares as their market price falls.

The second aspect, which concerns us greatly, is the result of the proposals on the movement of dividends from one Canadian corporation to another. Here you have the ridiculous situation, of the Government providing incentives with one hand and taking them away with the other.

Senator Phillips (Rigaud): That is par for the course.

Senator Laird: What happens to the foreign shareholders?

The Chairman: They would be subject only to withholding tax.

Mr. Winfield: The foreign shareholder does not get the creditable tax provision, he does not get the integration.

Senator Phillips (Rigaud): May I put this question to the witness. Have you an available study of the reasons why the United Kingdom abandoned this delightful procedure in 1965? Furthermore, have you a working paper or report as to why it was abandoned by the United States in 1965? If you have them, will you file them; and, if you have not them, would it be inconvenient or troublesome for you to prepare a summary, based upon the information given to you by the authorities in the United Kingdom and the United States?

Mr. Winfield: Mr. Chairman, we have such studies and will be delighted to file them.

Senator Phillips (Rigaud): As part of your brief in relationship to chapter 4.

Senator Burchill: In the example you have given of the comparisons, are the provincial taxes taken into consideration?

Mr. Winfield: I do not understand the purport of your question.

Senator Burchill: In the examples given down at the bottom of the page in chapter 4 are the taxes taken into consideration?

The Chairman: Those are individual calculations; individual taxpayers.

Senator Burchill: I know.

Mr. Greenman: The answer is yes, sir.

Senator Carter: Mr. Winfield, you refer to small companies, small by reference to size of income and capital employed. Could you give us figures to illustrate what you mean by a small company in terms of income or capital?

Mr. Winfield: Mr. Chairman, may I talk about small corporations generally and direct the senator's attention to the next page, which is headed "Small Corporations"?

We believe, Mr. Chairman, that there should be no difference in tax treatment between widely-held and large closely-held corporations. These corporations compete with each other and we would apply to both the 15 per cent dividend tax we have suggested and the same capital gains treatment; and we would remove the partnership option from both—at least from the closely-held corporations; and we would also remove the present low rate on the first $35,000.

Senator Aseltine: What about the personal corporations that do not bear any tax? Would they be considered as closely-held corporations?

Mr. Winfield: Yes, sir. If you look at the corporate hierarchy, if I may use that expression, you will see that if you take away the widely-held and the large closely-held then you really get down to talking about the small corporations, which we identify with closely-held corporations. So we think in terms of small closely-held corporations.

Senator Aseltine: But a personal corporation pays no tax now.

The Chairman: But, senator, under the White Paper the benefits that the personal corporation has under the present law will disappear.

Senator Kinley: Do you believe that the statutes we have now can do what you want?

The Chairman: If I may, Senator Kinley, I should like to try to develop the question that you are asking. First of all, Mr. Winfield, what you are saying is, in effect, that there should be a separate class or category entitled "Small Business of Corporations". Is that right?

Mr. Winfield: That is right.

The Chairman: And that they should have special tax treatment?

Mr. Winfield: That is right, sir.

The Chairman: A continuance of the 21 per cent rate?

Mr. Winfield: That is right. We suggest this special category of small corporations should be defined as to size, and there are several ways that that can be done. You can define as to size in terms of net profit or you can define in terms of capital employed. In thinking about it, Shell feels that probably two criteria are needed instead of one so that you try to remove too many borderline cases and, in effect, you have a notch provision which allows you then to avoid being too harsh on the company that is just below the criteria that you have developed.

The Chairman: You mean just above.

Mr. Winfield: Above, yes. We think that the small corporations should be given the partnership option and we also feel that they should be given the low rate, the 21 per cent rate on the first $35,000 of income, so long as the earnings are retained in the business and used for growth purposes. The moment they are moved out of the business in the form of dividends to the owner, then our suggestion is that the corporation should pay the difference between the 21 per cent and the maximum 50 per cent suggested by the White Paper.

Senator Phillips (Rigaud): Is this going to be practical in terms of determining earmarking the dividends in relation to surplus, if you do it that way? I foresee considerable complexity in the application of that principle. At a given point, when you declare a dividend out in years to come, how will it be possible to relate that dividend when there is a totality of surplus?

The Chairman: Senator Phillips, if you recall the evidence we have had so far on this point, the small businesses which have appeared here have said that they wanted their retained earnings because that really was the only source of capital they had for expansion. Therefore, you must assume from that that these retained earnings would be invested most likely in capital assets. Once you make that assumption, how are you going to earmark subsequent dividends that are paid out of retained earnings in a subsequent year as being in relation to that particular year and that capital expenditure?

Senator Phillips (Rigaud): That is why I put the question.

Mr. Greenman: Looking at the simplest possible procedure, sir, it would be a question of identifying this surplus on the books of the company. We are not talking about an elaborate figure; it is the taxable income of his return which has been taxed at this low rate, and this would be accumulated in his accounts; and our rule would be that the very first dividend out would be deemed to be out of this identified surplus. We see no mechanical problem, really. It is picking a few figures off the tax returns that he must file each year.

The Chairman: Mr. Greenman, that is really a variation of what we have in the act now, when we talk about a designated surplus.

Mr. Greenman: Yes, indeed, sir.

The Chairman: Under your plan you would call this a designated surplus?

Mr. Greenman: I hesitate to use that word. I use the word "identified" to avoid that confusion.

Senator Molson: Mr. Chairman, I wonder if what is contemplated here really justifies the effort. Assuming these small businesses are defined and this low rate applies only to truly small businesses, and assuming that there would have to be notch provisions, I wonder if the efforts involved to identify the surplus at a stage when it gets a little bigger and starts paying a dividend are worthwhile, because the amounts should be small. The 21 per cent rate is going to save perhaps $10,000 to the business.

The Chairman: Yes.

Senator Molson: Well, after ten years that is only a sum of $100,000, and, if it starts to pay a proportion of that in dividends, the dolar amounts are going to be relatively small. I am just wondering whether the proposal to define this small business and to limit the lower rate to small businesses does not in fact accomplish what is being sought.

The Chairman: Plus the other factor that you might have mentioned, senator, that when the dividend is paid the recipient will be paying tax on that.

Mr. Winfield: If I might comment on what Senator Molson has just said, at the present time the owner of the small business can, of course, get his 21 per cent rate on his earnings; he can withdraw it in dividends. Admittedly, he pays a normal personal tax on it, subject to the 21 per cent dividend credit that

he gets at the moment. I suppose, really, the proposal is merely to avoid the so-called abuse of this withdrawal of likely taxed earnings into personal income.

The Chairman: But they would be subject to tax in the hands of the person who gets them. If he chose to take them as wages or salary, they would be subject to tax in just the same way.

Senator Molson: It would still be a small business. The sums involved cannot very well be large or you would not get the benefit of the low rate.

The Chairman: That is right.

Senator Cook: Would you care to comment on the value of loss or profits which would constitute a small business?

Mr. Winfield: We have done no real studies on this. I do not know that I can really answer that question.

. **The Chairman:** You are only enunciating a principle.

Mr. Winfield: That is right.

The Chairman: I should point out to the committee that we had a bill before us a few years ago called the Small Businesses Loans Act and that bill as it originally came before us provided for loans for small businesses guaranteed by the Government, and the test of a small business was sales of not more than $250,000. More recently that provision for $250,000 was increased to $500,000. Now you will remember that we had Mr. Gaynor here the other day with the Retail Merchants Association, and he felt that the sales measure for small businesses as contained in the Small Businesses Loans Act was not a reasonable basis, and he and the rest of the panel thought that net profits would be the proper measure because on $250,000 of sales in Mr. Gaynor's business, which was men's furnishings and ladies' software, the net profit might be $10,000 or $12,000. So that on $500,000, if you said the profit was $25,000, you are talking about a very small business that would not even achieve the $35,000 limit. It would appear that maybe the best way is to define it by net profits and then the question is how much. It would appear from what Mr. Gaynor told us the other day that $100,000 net profit in a small business in his experience would not be a small business. It would be a very big business. So we did suggest to the Chamber of Commerce that we should perhaps be looking in the area of $60,000 to $75,000 net profits per year.

But there was one factor the other day that we did not get into, and I would like to ask Mr. Winfield about it now. What type of small business are we going to talk about? Are we thinking in terms of a commercial operation or are we thinking of things including land dealings or land rentals or investment income? When people talk about small businesses, I think the concept is a commercial operating business, and that is the way the small business benefits proceed in the United States under the present law, on the basis of commercially operating companies. Maybe this is an angle we should look at. Have you any comment on that, Mr. Winfield?

Mr. Winfield: We have not looked at it from that point of view.

Senator Kinley: In the Commons *Hansard* there is a list of what the different members thought was a small business.

The Chairman: The list was as long as the number of members.

Senator Molson: Mr. Chairman, if the standard of net profit only was used, I could foresee some cases that would then be defined as small business but which would not be small businesses at all. I think, as suggested by Mr. Winfield, you have to have more than one factor in establishing the definition of a small business.

The Chairman: Well, he has suggested the capital figure as well.

Senator Molson: I think there would have to be more than simply a net profit involved.

The Chairman: Yes, except that you might have a large amount of capital involved in the beginning and it might not be earning very much.

Senator Molson: But possibly that would not be a small business.

Senator Kinley: Mr. Chairman, is there not something in the White Paper that if a small business pays money out in dividends, they do not pay any tax on it? If you pay it out of the shareholders, the shareholders have to pay the taxes on it.

The Chairman: To the extent that a small business would qualify as a closely held cor-

poration. Dividends paid out under those circumstances would get full tax credit.

Senator Kinley: But if they gave it to the shareholders of the company, the company could not retain it. I think that is an undue invasion of the economics of a small business. It is interfering with the need for money to run the business. If they have to pay these every year, how can they get along? My friend spoke about the owners of small businesses, but how can you speak about the owner of a corporation? The owner of a corporation, if there is such a thing in this country, would be dealt with separately. It would indicate that one man owned the company.

The Chairman: Yes, senator.

Senator Phillips (Rigaud): I do not know if I got Mr. Winfield's reply. You say you considered the question as to whether small businesses should include operating companies as well as holding companies.

Mr. Winfield: No, senator, we have not considered it.

The Chairman: Have you any opinion on it?

Mr. Winfield: As far as Shell is concerned, of course, we are far more interested in the reasonable treatment of commercial businesses. Intermixed with our overall operations in Canada, we have to do a great deal with small businesses. And these are commercial businesses, and the sort of businesses that Shell is mainly interested in.

Senator Everett: Mr. Chairman, if we can come back for a moment to the previous page in chapter 4. In the example, Mr. Winfield, are you talking about the dividends from a closely held or widely held corporation? That is the example under White Paper proposals.

Mr. Winfield: Those are shares purchased on the stock market, so they are widely held. That is in all examples.

Senator Everett: Then in chapter 2 you have expressed quite legitimate concern for the middle income earner whom you have defined as one making $15,000 per year. Let us assume for a moment that we have such an earner and that he makes $12,000 per year and an additional $3,000 per year by way of dividends from widely held corporations. Do I take it that under the White Paper proposals his tax would be lower than under your proposals?

Mr. Winfield: Senator, I can only look at the figures I have available to me in this brief. But if you look at the left-hand column, you will see that with earned income of $7,000 and dividends of $2,000, under the present system the tax payable is $1,098 whereas under the White Paper it would be less; it would be $830. Without calculating it, I do not know what the difference would be on the figures that you have suggested.

Senator Everett: But it would appear under your proposals that the middle income earner who received a portion of his income from dividends would pay a higher tax than under the White Paper.

Mr. Winfield: Yes, sir.

The Chairman: Except, Senator Everett, you remember the study that Mr. Gilmour made as to where the increase in taxation not only caught up with the middle income group and was even in excess of the increase in the proposed exemption that such a person would get, and that that break-off point for a man with married status—I think it was around $9,000, was it not?—when you got to an income of $9,000, the benefit of the increased exemption had been taxed back at the increased rates.

The question you are putting now is a variation of that. That is, if you have some part of that income made up of dividends, how do the chips fall then?

Senator Everett: Well, the point I make is that I think it is an admirable suggestion. It is just that in examining these suggestions you have to examine individual situations, and one of the situations that Shell has raised earlier in this excellent brief has been that the middle-income earner is being hit. I suggest that one of the effects of their 15 per cent withholding would be to increase that tax again on those people.

Mr. Winfield: Exactly, senator, but we would hope that, once we had removed the distortions of integration and capital gains from the rate scale, it could be revised to provide for a lesser burden in terms of tax on earned income.

Senator Everett: Yes. Just to move to one other point, in your earlier roll-over provisions I note that you confine the advantage of those to widely-held corporations, and that they are not available, according to the definition you give, to holders of closely-held cor-

porations. Yet in this particular chapter I do not find any consideration being given to the problem of a closely-held corporation in the build-up of surplus or undistributed income which can only be removed by way of dividend but which, in the case of the widely-held corporation, can be effectively removed by leaving it in and seeing an increase in the value of the stock which is readily saleable.

Mr. Greenman: I think, senator, where our roll-over started was answering Mr. Benson's comment in the White Paper that there is a lock-in problem which would constitute a distortion to the capital market. I think that was his very expression. He said that portfolio holders would hesitate to move from stock to stock in the stockmarket because they do not want to pay tax on their gains, and he worried about them and said that we must therefore have our quinquennial revaluation so that these people will feel free to realize their gains, because they are going to be taxed anyway every five years, and that is where our suggestion got started. We proposed to solve it by the roll-over provision we have suggested. Also, of course, it occurred to us that this was a good way to stimulate reinvestment gains in the stock market. Our whole thinking was the stock market and what the White Paper calls the capital market. We were not thinking of closely-held corporations, I suppose, because these are naturally locked in and they are not turned over every day. So we did not have a lock-in problem to consider; nor did we have a capital market to consider.

Senator Everett: I think your proposal is very worthy. I am more interested in examining it, and anything I say does not reflect on the very worthy proposal you have made.

It seems to me that one of the things you should give consideration to, though, is the fact that if you have no roll-over for a closely-held corporation, if you have a 15 per cent withholding tax, if you have a limited capital gains tax, the tendency for people to develop business by way of closely-held corporations—and this is the way most businesses start—might be seriously jeopardized. And in considering what you are considering, a way out, not for these very small, closely-held corporations which, as you say, can be defined as a partnership, but for the larger—and I am not talking about the giant closely-held corporation, but the middle closely-held corporation, it seems to me you should give consideration to that problem as well. I agree with you that you validly have given the main consideration to the problem of the widely-held corporate shareholder. Do you have any comment on that?

Mr. Winfield: No, senator. I wish we could have spent another six months in preparing this brief, when we might have been able to think of something, but we really have not had time to do this, and we will certainly continue with our reviews of this whole problem.

Senator Everett: Do you agree that such a line of thinking is worthy?

Mr. Winfield: Yes, most definitely.

Senator Everett: Thank you very much.

The Chairman: What you are putting forward, Senator Everett, is a method of testing the proposal to see how all-embracing it is...

Senator Everett: With specific emphasis on the two areas I was talking about, the middle-income earner and the closely-held corporation.

The Chairman: ...whether it creates problems as well as solving problems.

Senator Molson: Just before we leave the personal income tax, I would like to ask Mr. Winfield two questions.

One is that in the course of our hearings we have had it suggested that it would be very simple to reduce substantially the sales tax and to spread that equitably over the spectrum of the graduated income tax.

I remember we asked a good many questions about how this would be proposed, but I would really like to ask Mr. Winfield whether he would accept that premise, that it would be awfully simple to carry out this suggestion. He has already said that the present effect of the White Paper is to compress the impact of taxation on the middle group. I think the figure that was used was that the sales tax generally earned about $2 billion. If that were added to the load, what would he see as the effect on the income tax structure?

Mr. Winfield: I have not even thought about it in my wildest imagination, senator.

The Chairman: If the present integration as proposed by the White Paper is adopted in the middle group to recover, in part, $1 billion loss of revenue, you can figure that to

make up another $2 billion they might have to increase the rates by two, three or four times, which in my view just becomes a fantastic concept.

Senator Molson: This is why I was asking.

Mr. Greenman: I would think, senator, that the problem would be that you could not do it all at once. It would have to be shifted over a very long period of years, because, after all, it is a transfer of tax burden. The sales tax is regressive. Everybody pays the same amount regardless of his ability to pay under the commodity tax concept. So, it would be a transfer to the graduated rate schedule, and a major transfer of burden. The rates of this commodity tax or manufacturer's sales tax, as it has existed for many years, have gradually risen. There has been a shifting of that tax burden. The weight of tax has been shifted, and various equilibria have been reached. I just cannot imagine the repercussions there would be if they were disturbed at one fell swoop. I would imagine that over a period of years you could reduce the manufacturer's sales tax by one percentage point every other year. You could engage in that sort of thing. If you did it gradually, then with the growing prosperity and increased incomes of the people I suppose the revenue situation of the country would enable a fairly smooth transition. But, surely, we are talking about ten, fifteen, or twenty years.

The Chairman: To make it acceptable, Mr. Greenman, to those who presently pay sales tax, and who might be called upon to pay an increased tax called personal income tax, you might have to guarantee to them that their commodity prices would go down to the extent that they had been affected by the sales tax.

Mr. Greenman: Yes, that would be a *sine qua non* of that procedure.

Senator Molson: It would strike the same middle income group if it were applied. I doubt the practicability of it, but I am interested in the answer.

The other question I have, Mr. Chairman, is: Have Shell given any consideration to the question of co-operatives in this income tax picture which is now being completely reformed under the White Paper?

Mr. Greenman: No, I am afraid we have not gone into that complex subject. There is a very strong and knowledgeable organization looking after the interests of people like ourselves who suffer to some extent from competition with co-operatives. We have not got into that battle as a company, and on this occasion we gave it no consideration at all.

The Chairman: Shall we move on to the next head, Mr. Winfield?

Mr. Winfield: Mr. Chairman, I turn now to chapter 5 where we deal with the operators' depletion allowance. I might mention that we have tried for several years now to convince the Minister of Finance that he should remove the present disincentive inherent in the net depletion rules which apply today.

We really like the concepts in the White Paper which are designed to encourage exploration. We are concerned about the grant-like quality—they are grants rather than allowances, confined as they are to reward for work done—when compared to the generous allowances of our U.S. competitors.

So Shell, in thinking this over, has come up with a formula which really charts a middle course between the Minister of Finance on the one hand, who says that depletion allowances or grants will only be given on the basis of how much work is done, and the U.S. system, on the other hand, of a percentage of operating profit. We call this a half-and-half formula—one-half to encourage exploration, and we suggest a formula of an allowance of $1 for every $4 spent, and one-half to encourage the major risk taking aspects inherent in exploration for oil and gas by a percentage of allowance on production revenues. We accept reluctantly—and I underline the word "reluctantly"—if protection of Government revenues is required, the 33⅓ per cent net maximum that is proposed in the White Paper.

The Chairman: As a depletion allowance?

Mr. Winfield: Yes, as a depletion allowance. We still do not like this because it contains this inherent concept of a disincentive to explore.

If you look at the two examples we have outlined in our brief on the left hand side of the page, you will see that example 1 applies to a major producing company with no exploration program. You will notice there that under the present law the allowance is generous. The operator gets 33⅓ per cent of net profit. His net operating profits are $6,000. Since there is no exploration and develop-

ment his net profit subject to depletion is still $6,000, and he gets $2,000 as an allowance.

In the second example, again under the present law if you will bear with me, we have a growth company with a very heavy exploration program. Here we show net operating profits of $6,000, and exploration and development of $4,000, leaving "net" profit of $2,000. Here the allowance is 33⅓ per cent of the net of $2,000, which is $667. You will notice that between these two examples there is a disincentive inherent in the present law to the operator's spending that $4,000. He would be much better off if he did not spend it.

Incidentally, of course, under the present law there is no carry forward of any depletion. You either earn it in the year and use it, or, if you cannot use it, you cannot carry it forward.

If you look at the second column you will see that it shows the White Paper proposals. For the mature producing company with no exploration program the White Paper provides nothing, since it is a system which is tied in the form of a reward for work done. Here you see a situation which Mr. Bridges mentioned such as that of the tar sands where you have little exploration, but hopefully large operating revenues, and where the present scheme would provide no depletion allowance at all.

As to the growth company with a heavy exploration program, you will notice from the example below that the White Paper proposes a one for three formula. It is a third of the $4,000 spent on exploration and production. It provides an allowance of $1,333, but then provides to keep this down as a maximum to restrict it to 33⅓ per cent of "net", but it allows you to carry forward what it has just taken away from you.

Shell Canada has come up with this middle course proposal, and you will notice from the examples in the red column that the mature producing company with no exploration program under our scheme would get ten per cent of the assumed gross revenues, which in this example we have taken at $10,000 or $1,000. For a growth company with a heavy exploration program the allowance would be one-fourth, or $1,000 of the $4,000 spent on exploration, and $1,000 in respect of the ten per cent of the assumed gross production revenue. Here the allowance we propose is $2,000, but it is again subject to the maximum of $667 or 33⅓ per cent of "net", but we would carry forward the difference, the use of which is prevented by this maximum.

Senator Connolly (Ottawa West): In that year?

Mr. Winfield: You would carry forward to future years what you had not been able to use in that year.

The Chairman: Mr. Winfield, there are two points, it seems to me, in connection with your proposal: one is that companies are operating and have financed their operation on the basis of the existing depletion allowances. This will be a sudden change in midstream. What comment have you to make on that?

Mr. Bridges: It would be less of a change in midstream than the White Paper proposal, because the proposal in this case is to entirely remove the incentive to this particular type of company.

The Chairman: Yes, therefore the least desirable change would be the White Paper proposal.

Mr. Bridges: No, on the contrary. We are talking about the first example, the mature company?

The Chairman: Yes.

Mr. Bridges: The White Paper proposal will remove the incentive completely. Even though this man may have found his mineral deposit or oil field only a few years before this system was introduced, he has paid his bonus for it and paid all his expenses on certain assumptions of a certain tax regime, which is suddenly taken away from him. He gets no depletion allowance whatever and then has to pay full corporation tax.

The Chairman: No, this is not the aspect I was referring to. Imperial Oil said here that the depletion allowance in the form in which they earn it is necessary, and if it were not continued in that form, or a change of plan effected which would give them at least the same, the tar sands development, for instance, would not be feasible.

Mr. Bridges: That is exactly right. That is why I believe we must have an entirely different system even from this for the tar sands, which should be on a separate basis entirely, preferably gross depletion basis rather than like the one existing in the United States. Maybe that will not be enough incentive to get the sands developed as quick-

ly as they should be developed, and the Government may have to think in terms of other incentives, such as much lower royalty rates than exist.

The Chairman: Imperial Oil also suggested that the ceiling under the White Paper should be a percentage of gross income, not the net.

Mr. Bridges: Right; it is a good system. It is used south of the border. Theoretically, if capital exists and it has a choice between moving into Canada or exploring in the United States, it will go to the place where the depletion allowance is best. It is better at the moment in the United States than it is here, and certainly will be under the White Paper proposals.

The Chairman: To be competitive in the U.S. market for the sale of crude oil you would need to keep the allowances in both countries pretty close together.

Mr. Bridges: Right; the important thing in this gas game, where you are spending a lot of money on exploration if you are a good growth company, is that you have to physically get the gas to put into the extra exploration. This means that you have to have some form of tax incentive. You cannot be put on the same basis of paying full corporation tax and therefore having to find this money in another direction. You have got to be given the opportunity to re-invest by effectively paying tax at the lower rate. Otherwise this exploration will not proceed at a fast enough pace to develop the resources that we need to develop in Canada. Therefore one is really only considering which system gives you the best kind of incentive.

The Chairman: You did not give very good treatment to the first question I put, Mr. Winfield, but let me explain it. The mature company, which is one of your examples, once upon a time was not a mature company. Therefore it had to find money. This was risk capital and that risk capital came into the venture on the basis of the then existing incentives.

Mr. Winfield: That is right.

The Chairman: Now it has moved along to become a mature company and may not be developing and exploring to the same extent. However, if it does not, then its position under the White Paper proposals is worse than its position in the present law, yet this is what I was referring to as changing the rules midstream. I do not think that when you were answering my question originally, Mr. Winfield, you were thinking of that aspect of it.

Mr. Bridges: The word mature is a little unfortunate here because it gives the idea of a company that has done no exploration for the last 15 or 20 years. I would like to emphasize the time cycle in this exploration business. You acquire your lands and start to explore with geophysical methods. This phase may well take four or five years. If you are lucky, you find something and then you have to start a program of development. Finally, if you have confirmed a discovery and start building all your facilities, including gas plants, pipelines, and so on, you have a hope that about ten years after you acquired the lands originally you can get into production and start earning some income for the first time. It is this long time span which makes it necessary, in our opinion, to have a depletion allowance, some form of tax incentive in other words.

The Chairman: I understand the depletion allowance to the oil and gas industry in the U.S. is about 22 per cent of the gross production income.

Mr. Bridges: That is right.

The Chairman: Is the design of your proposal such that it may produce a figure by way of incentive close to the U.S. figure?

Mr. Bridges: Yes, indeed. Basically we started off with the idea of trying to design an incentive scheme which would have the same financial impact.

Mr. Winfield: The red column indicates that the allowance is made up of the $2,000, totalling $2,000, which is 20 per cent of the gross income of $10,000. So it equates pretty closely.

The Chairman: Yes, on your example it does, but I do not know how it would work out.

Mr. Winfield: We built all sorty of models on this, but it is very difficult to be absolutely specific.

The Chairman: We have been told by Noranda that mining operations should continue in a separate category from oil and gas so far as tax incentives are concerned. Imperial Oil refused to commit themselves in that area. What would your position be? The

White Paper puts them all together, mines, oils and gas.

Mr. Bridges: We are not engaged in the mining business at Shell Canada. Therefore we have not made any special study of the mining aspects except in so far as they apply to the Athabasca tar sands. Our conclusion, of course, very quickly was that the White Paper proposals defeated the entire objective of, we would hope, encouraging Athabascan tar sands development. That is why we made a plea, without putting any special proposal forward, for consideration to begin for an entirely different kind of incentive for the Athabasca tar sands.

The Chairman: That is whether your operation in the tar sands might be regarded as mining?

Mr. Bridges: As mining, for the surface deposits where you have mining.

Senator Connolly (Ottawa West): I should like to take the case of the mature producer with no exploratory program in contemplation. First of all, would you agree that it is not appropriate for an oil and gas company like yourself to have no exploratory program? You must continue constantly because your assets increase that much more quickly, you have to keep discovering. Is that so?

Mr. Bridges: Yes.

Senator Connolly (Ottawa West): In the case of a mining operation, or perhaps tar sands which are equivalent in some respects to mining, where there is a body of resource, whether it be mineral, or in that case oil, there is really no incentive to go exploring. Say for the sake of argument the deposit is good enouh to last for a hundred years. If depletion is now taken away from a company in that position on the principle of earned depletion, they do not want to do any exploratory program so they just do not earn any, what ill effects flow from that?

Mr. Bridges: If we look at the tar sands and try to compare that with a mineral venture, such as a uranium venture, first of all it is true that the reserves are so huge in that area—you might call them unlimited—nevertheless you cannot mine them with one mine, as it were; you have to have certain units; you have to have a certain unit of production, which is the kind of thing you would set up almost as if it is a separate venture. You do one of these, and a few years later you start another one. Therefore effectively, although you are not exploring in the sense that you know your reserves are there, you are starting a new venture every three or four years. I think this basically applies to uranium, or something like that, equally as well, although we have not made any real study of that kind of thing. I therefore think you cannot remove the depletion provisions from any of these mining ventures without risking stopping them altogether.

Senator Connolly (Ottawa West): Then perhaps I could ask you a further question. The chairman fashioned a definition of depletion, I think at the time Noranda were here, in which he said depletion was really an attempt to repay the company that took the risk for the wasting nature of the asset and to restore the equivalent. In that context, would depletion still be a valid thing on the basis of the present law, even if it were not an incentive to do further exploring? Would it still be an appropriate incentive, in your view?

Mr. Bridges: I would think only if the original venture was taken out on the basis of a certain regime, and would never have been undertaken because if it had not had that regime it would have been too expensive.

Senator Connolly (Ottawa West): Let us assume that the original venture was financed on a certain set of tax arrangements, which exist today; then the concept is changed completely and depletion is washed out, but the capitalization of that particular deposit was predicated upon depletion as it existed. Is there some injustice done as a result of the removal of the depletion?

Mr. Bridges: A gross injustice in our view, yes. It is not right to change the rules in the middle of what is really a very long game, the mining or the oil business.

Senator Connolly (Ottawa West): In effect, what you are saying is that if the change is to be made as in the White Paper, if they stick to this principle of earned depletion, it should only be for newly discovered properties in the future, and then perhaps it is questionable.

Mr. Bridges: That would be one way of looking at it, yes.

Senator Everett: Do you have any idea to what depletion on net income a depletion on gross income calculated at 10 per cent is comparable?

Mr. Greenman: We think that under normal circumstances 20 per cent of gross production revenue equates to 33 1/3 per cent of net operating profits, which is gross revenue with the operating costs, the lifting costs and tax depreciation, deducted. We are not now talking of deducting exploration and development. We are talking of our $6,000 in example No. 1. Indeed, you will see our 10 per cent of $10,000, which we use on a later page, with $10,000 gross production revenue less $4,000 operating expenses equals this $6,000 of net operating profits. You will see the whole example is based on 33⅓ per cent of that net operating profit, or $2,000.

Senator Everett: But that is net after exploration?

Mr. Greenman: No, sir. That is example No. 1, where there is no exploration or development. But that 33⅓ per cent of net, which is $2,000, is normally equal to 20 per cent of $10,000, the gross production revenue. This is awfully hard to come by, and we have done quite a bit of analysis. The same thing was done by the Carter Commission's advisors a few years ago. It does keep changing with changing conditions. We feel that it is somewhere between 20 per cent and 25 per cent. We have decided that 20 per cent is the fairest assessment of the normal situation. There are, of course, marginal wells, where the costs are high relative to the gross production revenue, in which case this equation will not hold. However, we thought this was a sort of average, normal situation.

Senator Everett: In chapter 5, on page 2, in the fourth paragraph you say the proposals in the White Paper are unrealistic because:

> If half of profits never to be realized, rate of return on new projects cannot be attractive. No one will spend money just for sake of allowances.

Then in the final paragraph, in dealing with your proposal, you suggest that the Government:

> ... set reasonably high work requirement: with formula of $1 of allowance for every $4 spent on exploration, development and Crown land acquisition costs: producers could only obtain full extra 10 per cent by reinvesting 66⅔ per cent of their operating profits.

Unless I have misread that, it seems to put a tougher obligation on the producer to achieve the maximum deduction in the White Paper which talks of 50 per cent.

Mr. Greenman: Ours was a composite formula.

Senator Everett: Let us deal with that one part of the formula. Your statement there, in order to get the extra 10 per cent, is that you must spend 66⅔ per cent of your profits as compared to your critique of the White Paper in which you say that in order to get the full allowance you must spend 50 per cent of your profits.

Mr. Greenman: We would have been very glad to leave the second part of our formula at $1 for $3 as in the White Paper or as some are recommending $1 for $2. We were trying to be as reasonable as possible and when we settled at 66⅔. That is how we get the $1 for $4. We thought we were being reasonable and that is about the only explanation I can give you.

Senator Everett: You might be reasonable at $1 for $2. That is possible.

The Chairman: Possibly what you were seeking to achieve was a figure of incentive for depletion of 20 per cent of gross producing.

Mr. Greenman: That was our target.

The Chairman: The moment you took the 10 per cent on the basis you had set out then all the room you had left was taken up by your proposal.

Mr. Greenman: Mathematically that is the way it worked out.

The Chairman: You did it by mathematics without considering the needs of the industry or whether $1 allowance for $4 spent is reasonable in itself or not. Your answer to that might be no.

Mr. Winfield: That may be the case, but I think we had to contend with the department on the one hand, saying that we will give you $1 for $3 on a work basis only and the need to modify this and get acceptance of a reasonable modification. I think that our suggestion is about as far as we think the department is prepared to go.

The Chairman: I do not know how you can compare these two. If you start out with the objective you need 22 per cent of the gross production income in order to be in a competitive position to honour obligations incurred on the present basis of the law. Surely you then have to stick with a plan

that does not require you to spend so much money on exploration in order to achieve the 20 per cent. The only way in which you can get up to 20 per cent is by spending a lot of money on exploration and spending, say, $4 and only getting an earned depletion allowance of $1.

Mr. Bridges: That is absolutely correct if one is going to base the incentive solely on new exploration. We are saying that one should still get an incentive for the money you put in over the last 20 years or so.

The Chairman: I do not get that in the spending of $4 and getting an earned depletion of $1.

Senator Everett: That is the other half.

Mr. Bridges: If you would like to argue us into the comparative position of 20 per cent gross it would be easy to do so.

The Chairman: I am suggesting that maybe you should argue yourself into that position. All I am doing is to point out the situation.

Mr. Bridges: Mr. Chairman, we approached this from the point of view of the fact that the Government wants to have some tie-up between the allowances granted and new exploration. We said this is not unreasonable and that one way or another he wants to prevent a company from doing what is shown in example 1, of no exploration at all. He wants to really make them do some work. How do we meet his wishes without removing altogether the depletion for past expenditures. We adopted this half and half proposal which, as you say, is mathematically designed to meet the 20 per cent. It is not ideal and the worst thing of all and the part we do not like—that is why I don't like to see this called the Shell recommendation—is that we would still want to have a limitation of the maximum 33 and one per cent of net. One would like to see this allowance coming back to you in the year in which it is earned so that the money is available for reinvestment for the next year.

Senator Everett: Rather than being carried forward.

Mr. Bridges: Exactly.

Senator Everett: Do you think there is a possibility that the $66\frac{2}{3}$ is not a sufficient incentive if indeed the 50 per cent may not be, excluding for a moment the 10 per cent of gross? Do you think it is possible that the $66\frac{2}{3}$ requirement or the $1 for $4 is not too steep and that may be so steep that people or producers will not do as much exploration as they should?

Mr. Bridges: We feel that if we could have this restriction removed of the maximum of $33\frac{1}{3}$ per cent net that this combination is a good one for an active growth company.

Senator Everett: Part of your idea would be to have a restriction of $33\frac{1}{3}$...

Mr. Bridges: Removed.

Senator Everett: You have included it in there?

Mr. Bridges: We do not feel it should be, but that the minister is going to demand it.

The Chairman: We are supposed to be listening to your representations. If you keep making them all on the basis of looking out of one corner of your eye at the minister we are getting something less than what you think would be the greatest benefit to your company.

Mr. Bridges: In that event we would like to change our recommendation and move the maximum of $33\frac{1}{3}$.

Senator Phillips (Rigaud): Mr. Chairman, the compromise is to avoid the evil suggestion that there is a lobby.

The Chairman: I do not think it has been suggested that there be a lobby.

Senator Everett: Is it a fact though that this suggestion that you make is predicated really and entirely on the taxfree passage of intercompany dividends and the fact that there is no non-creditable tax feature regarding shareholder dividends. If you don't get those even this system does not work?

Mr. Bridges: Exactly.

The Chairman: Can we move on, Mr. Winfield?

Mr. Winfield: Yes, Mr. Chairman. I can be very brief on the rest of my comments. The transitional period allowances which is on the next page catches the operators in various stages of exploration and development and of course continues the incentive we have been talking about for the next five years and may cause people to respond in their exploration. The Shell provisions would remove the whole necessity for any special transitional period measures.

The next page deals with the non-operators depletion allowance. I can only comment here that we think it is a bit unfair to remove this for people who expected its continuance.

The Chairman: We have developed that, haven't we?

Mr. Winfield: Yes. The Shell formula could be applied with the limitation of 20 per cent. In any case I would point out to you, Mr. Chairman, that the whole thing, the proposals in the White Paper can be circumvented quite easily by converting royalties into interests which have some participation in operating profits.

The Chairman: On your rental building loophole.

Mr. Winfield: This is a minor point. We are concerned because we have a lot of service stations and a lot of property and the proposals puts us in the ridiculous situation of possibly taking a loss in one department and a profit in another department of the same company and not being able to offset one against the other.

As far as capital costs allowance is concerned we merely state our position and hope that the Government will enlighten us as to what they mean by generous.

The Chairman: As a matter of fact you might be back here again some time or another when any variations in capital cost allowances are proposed and maybe there will be what they call participatory democracy at that time.

Chapter 6.

Mr. Winfield: I have three very short comments. We think that the present straightforward fiscal system is consistent with Canada's interests as a trading nation and as a capital short nation. That is to say, taking three portions of international capital and enterprise, provided it is modified to prevent the diversion abroad of Canadian source income and is strictly enforced, is provided in the present law, with the exception of the modifications.

The concept of Canada acting as an international tax policeman and reaching out to impair the competitive position of Canadian business abroad by nullifying any tax incentive granted by the host country, seems senseless.

Senator Phillips (Rigaud): May I put a question, similar to that which I put earlier with respect to the abandonment by the United States and United Kingdom of the grossing provisions. My understanding is that in the United States an intensive study has been made by government as to the involvement resulting from the complexities of the application of the so-called offshore operations. Have you a study on that subject, and have you any information as to the present intention of the United States with respect to the treatment of offshore company profits?

Mr. Greenman: We are talking in this area of passive income, this attempt of Canada to tax it annually, not waiting for the repatriation of dividends. This is the sub-paragraph (f).

Senator Phillips (Rigaud): I am talking about the adherence of the United States with respect to its attempt to tax passive income in the sense of income that really was not based on United States operations. Have you any information on it?

Mr. Greenman: I am no expert on it, sir. I understand that they have found it to be something of an esoteric matter. There are only a few people in the whole country who really understand it, and they have found it unwieldy and they are on the verge of backing off that attempt to tax currently that passive income.

Senator Phillips (Rigaud): I was hoping that you would answer my question in that way. My understanding is that the United States Government is on the verge of abandoning its current procedure.

Mr. Greenman: Canada also proposed, that quite apart from the passive income. At first they proposed in the White Paper to impose Canadian tax at the time of dividend repatriation. Any Canadian tax could take up any slack that has been left by a low rate country, so that we are really talking about two things in our brief.

Certainly, we would not consider the subpart (f) as something we ought to go into. But quite apart from that, we are making the point with regard to ordinarily controlled corporation foreign income, that we do not think Canada should reach out to try to collect the tax that the low rate country has deliberately spared our Canadian corporation, operating or controlled corporation, operating under those competitive conditions.

Senator Phillips (Rigaud): In my experience—I am thinking now as a professional

man—the problem is defined as a Canadian source income as distinct from a Canadian passive income. It is an area of no mean complexity, and I was wondering whether you had any working data on that which would be helpful to this committee?

Mr. Greenman: Nothing...

Senator Phillips (Rigaud): You have used expressions in your brief, and properly so, because it is the only way to define it. But in practice, it is quite a problem in bringing about the differentiation, in certain instances. My question mark—have you any working material on that?

Mr. Greenman: Nothing especial, sir. We did not foresee the problem that you are bringing up, of defining Canadian source income. We think that there are a few loophole closing provisions necessary, or stricter enforcement of the law. I am not sure I know the difference between the two. We sometimes speak of offshore traders, which is the case of buying something in a supplying country, taking the purchase into the tax payment country, and then selling it to Canada at a profit, and keeping the profits in the tax payment country. We think of that as a diversion of Canadian source income.

Senator Phillips (Rigaud): I do not want to hold up the business, Mr. Chairman, but this to me is a vital point in relation to the treatment of offshore companies. Could we get from these gentlemen a memorandum of two examples in relationship to chapter 6—example one, where you would regard the income of the offshore company as being Canadian source income and, example two, where you would consider it passive income. Two simple examples.

Senator Kinley: What do we mean by "offshore" income?

Senator Phillips (Rigaud): Non-Canadian.

Senator Kinley: It has no marine aspect, has it?

Senator Phillips (Rigaud): No. Foreign.

Mr. Greenman: I think the White Paper gives one simple example of diversion of Canadian source income. They speak of Canadian interest being paid on Canadian bonds, which is paid to a tax payment country and then comes back into Canada, tax exempt, because of section 28(1)(d), in which case the only tax it has borne is the 15 per cent withholding tax when it passed out of Canada on the first round. The White Paper also speaks of diversion of Canadian source income.

Senator Phillips (Rigaud): You might think about it. It would be very helpful to us. You could get the Canadian source income. Obviously, in an attempt to avoid the so-called law of Canadian control, even though you have the foreign corporation, in this case it would be a tax Canadian source income added to the directors of the offshore company.

I would like to get an interesting example of a setup of a wholly-owned subsidiary of a foreign company, where you get the benefit of that in the foreign countries, and where it is absolutely absurd to regard that income as passive income of a Canadian parent.

Mr. Greenman: Naturally, we think of the kind of tax burying that is the subject of our brief. We think of a Canadian group setting up a shoe factory in Bermuda, if you will; and if Bermuda imposes a low rate of corporation tax on that shoe business; then we would think it would be fair to leave it that way, for Canada not to intervene taxwise, so that if Bermuda has a low rate to stimulate the establishment of shoe factories within its shores, then we should not nullify that attempt.

Senator Phillips (Rigaud): Would you say, to tidy it up, then, with respect to passive income, that passive income is income of non-Canadian controlled subsidiaries of Canadian parents, where profits are truthfully related to operations outside of Canada, directly or indirectly, and without their being present any avoidance or minimization of profits on the part of the Canadian parent or any Canadian subsidiary offsetting the Canadian parent?

Mr. Greenman: Yes, that sort of definition. I do not believe that passive income definition has anything to do with intent. As I understand it, passive income is the opposite of the shoe factory income, that is, it is the receipt of dividends, the receipt of interest, and this trading operation which I believe the White Paper refers to as trans-shipment profits, the existence of a merchant to buy and to sell again.

The Chairman: Yes, because it would be related to Canadian income and therefore in effect it is minimization or avoidance of tax.

Mr. Greenman: We would not interfere with even that passive income, provided that the income in question was not Canadian source income. If it happened to be Swiss source income, taken to Bermuda, we would not think that, just because of its Canadian control, that Canada should intervene to tax even that income.

Senator Phillips (Rigaud): Let me ask you this: if Shell Canada had a wholly-owned subsidiary in the Caribbean and Shell Canada sold its Canadian commodity to the Caribbean company without there being a commercial reason for so doing, would you regard the Caribbean income as properly the income of the Canadian firm?

Mr. Greenman: We would think that Section 17 which would impose upon us the obligation to sell at a fair price would take care of the situation. We would think also that the central management and control of such a subsidiary, unless we deliberately rigged the thing, would be in Canada and it would, in fact, be a Canadian resident.

Senator Phillips (Rigaud): Yes.

Senator Carter: In your brief you say that the:

> —"tax treaty test" proposed is impractical, inequitable and non-neutral;

Then you go on to say that:

> ...it is known that some important nations see no advantage in completing a treaty with Canada.

I wonder if you could tell us what nations you are referring to.

Mr. Greenman: I have not made a complete review, but I am told that the typical country in this category would be a South American country in a high state of development which does not need a reciprocal arrangement with Canada because its nationals do not need protection from Canadian tax. A treaty usually arises because both nations see that their nationals need protection in the other state, and so it is reciprocity that is involved. If, of course, you are a country whose residents have no concern with Canada by and large, then why should you consummate a treaty that would spare Canadians investing in your country? That is the sort of philosophy I believe is held by many countries around the world, but I most often hear it mentioned in respect of certain South American countries.

21849—3

The Chairman: It might be difficult, too, Mr. Greenman, if you have another country which provides a tax holiday of up to five years for development of mineral resources to expect that that country would enter into a treaty with Canada on some reciprocal basis when Canada is proposing to do away with the tax holidays. What would be the attraction for that foreign country to do that? They would get the development by virtue of the incentives they offer and the only purpose of a tax treaty with Canada might be for them to bargain away some of that, and I don't think you can expect they would do that.

Can you tell me how much income tax you paid in 1969, Mr. Winfield? And have you done any calculation to show whether the amount would be up or down on the basis of the White Paper?

Mr. Winfield: Mr. Chairman, Shell Canada is always liable for taxes on all its profits, but because of the very heavy exploration and development expenditures which we have incurred over the last many years in Canada, we have large tax carry-forwards. In other words, we have not been able to make enough taxable income to absorb these drilling and exploration expenses so, in effect, in 1969 we did not actually pay any tax.

The Chairman: What you mean is that you have a deferred liability.

Mr. Winfield: That is right. We have made some calculations. Mr. Bridges mentioned that, had the unrealized gains tax been in effect, then, this being the fifth year, the parent companies would have had to pay $80 million. We did some calculations on the basis of dividends flowing from Shell Canada to its parent corporation in Canada, Shell Investments Limited, and the tax in Shell Investments' hands on the transference of those dividends would have been $5 million.

This is the business of creditable tax gain. Shell Canada in 1969 would have had no creditable tax and, therefore, the recipient company, the recipient of the dividends, would have had to pay tax on those dividends, and this amounted in our calculations to about $5 million.

The Chairman: I see you develop this point under the heading of income taxes in your 1969 Annual Report.

Mr. Winfield: Yes, sir.

The Chairman: Is that part of your brief, or are you filing it?

Mr. Winfield: We have asked to file our Annual Report for 1969, yes.

I just wanted to make one last point on pensions, Mr. Chairman. We merely want to say that we question the wisdom of Canada's taking unilaterally a position on pensions contrary to the generally accepted international convention that pensions are left to be taxed by the host country. By so doing Canada is setting up obstacles to the retirement of its citizens where they choose.

That concludes my remarks on the brief, Mr. Chairman.

The Chairman: Thank you.

Senator Desruisseaux: Mr. Winfield, some of us are for the implementation of the White Paper and some of us are against it. If for some reason the White Paper were implemented, what would be the consequences so far as your company is concerned in its dealings in Canada in respect of exploration and drilling?

Mr. Winfield: Well, it would mean the discontinuation of the existing depletion rules which we have described as $33\frac{1}{3}$ of net, and it would, in effect, mean that the very large exploration program in which Shell Canada is now embarked would result in the company's losing the depletion on the present basis. And as Mr. Bridges put it, the problem is always facing us in this form: Will the tax climate in the country allow us to build up enough resources to do the job we think we have to do?

Senator Desruisseaux: What is the amount involved there? What would be the amount involved last year, for instance?

Mr. Bridges: This year we are spending $90 million on exploration.

Senator Carter: Mr. Chairman, coming from the Maritimes, the Atlantic provinces, I should like to ask the witnesses what effect the White Paper proposals will have on their explorations off Canada's east coast.

Mr. Bridges: I think Mr. Winfield has just answered this question in slightly different form. As of now we are going ahead with this very expensive program off the east coast in the belief that, if the Government should decide that there are to be changes in the rules under which we operate, those changes will be of such a nature that they will not affect our desire to go on investing at the maximum possible rate.

Senator Carter: Will it slow down or terminate your exploration?

Mr. Bridges: We are going ahead on the basis that we hope whatever new legislation comes out will not slow things down. We will simply have to examine the legislation, however, when it does come out to see if in fact we will have to change our current view.

The Chairman: If the implementation of what is in the White Paper came to pass, then what?

Mr. Bridges: The point is, of course, that if we could be sure that we are going to find vast oilfields in the new frontier regions of Canada, we would go ahead in any case to look for them, irrespective of Parliament. In fact, if we knew that you were going to get Middle East type production in some of these areas, we would not be pleading for a depletion allowance; we could forget it. They don't have one in the Middle East, and we would not need one here if we had that type of production. But we do not believe that we can expect that kind of thing. We believe that if we are fortunate, we are going to find some oilfields offshore which we will be able to develop if the tax rules are favourable. Now the White Paper proposals as they stand would not, in our view, constitute favourable conditions for that development.

Senator Desruisseaux: I have one question, if I may, Mr. Chairman. If the White Paper was implemented, how would we fare in comparison in the case of treatment regarding explorations for these companies or for Canadian companies? How would we fare? We have a wonderful knowledge of what happens here and there, and there are different views on this.

Mr. Bridges: If we take depletion allowances alone, North America—that is the United States and Canada—are virtually the only two countries in the world where this type of depletion allowance exists. But by the same token it is the only place in the world where one is looking for reserves of the type we are finding in Alberta, British Columbia and Saskatchewan which are expensive to find. It may cost as much as $1 per barrel to find the oil in the ground, and that is even before you start to put your money in to devel-

op it. That is compared with most other parts of the world where your finding costs may be as low as 1 cent or two cents per barrel. It is a ratio of 50 to 1 in finding costs alone. That is our experience up to now in North America compared with the Middle East or Australia or some of these other countries. So what we are saying in fact is this; as long as you are looking for that type of accumulation, for the small accumulation that is difficult to find, it is simply a must to have special regulations compared with other countries.

Senator Connolly (Ottawa West): If I may ask a question of Mr. Winfield. I ask this question because I think you may have left the committee with the feeling that you do not pay taxes at all because you do not have to pay income tax by reason of your exploratory program. I am looking now at your annual statement, and on page 18 you show taxes, other than direct retail and income taxes for the year ending December 31, 1969, at $45.5 million, so that your company is not escaping taxation in Canada.

Mr. Winfield: On the contrary, senator, we are not escaping taxation. I think you could look at it this way, senator. If two people were in partnership, you would expect the partners to share in both the profits and the losses of the concern. Now government is in partnership with business, whether we like it or not, and they are not prepared to share in the losses until the business generates a profit. In other words, the contribution which the government makes to the business by allowing deduction of expenses does not operate until there is a profit. So what has happened to Shell Canada is that it has had to spend and has spent all this money on exploration and development without any government contribution at all. We are now offsetting these expenditures against taxable income, and this is the way government now allows us to take their contribution. When we are in a profit-earning position, we will start paying tax. But it is quite definite that on every dollar of taxable income, we pay tax.

Senator Connolly (Ottawa West): Yes. I think perhaps you might have left the impression that you were not paying any taxes, and that is why I raised the question.

The second question I would like to ask is this; you also show in your annual statement that you pay dividends, and last year they were in the amount of $16.6 million on common stock. Now, normally dividends are paid on profits realized. Yet, you are not in a profit position.

Mr. Winfield: Yes, sir, we are. We are in a profit position, but we have what we call a backlog of drilling and exploration expenses. In other words, in our income tax return we take our profit and adjust it in accordance with the Income Tax Act and come up with a taxable income figure. Now we would normally pay tax on this taxable income figure, but we still have these drilling and exploration expenditures which have accumulated in the past and which offset this taxable income. That is the position. But we are still making a profit.

The Chairman: We are getting very close to the 12 o'clock deadline for adjourning.

Senator Hollett: Mr. Chairman, I have a question, if I may ask it.

The Chairman: Yes.

Senator Hollett: I notice in your exploration figures you have $1,400 million for exploration, etc. How much of that money was spent to decide or to come to a conclusion as to the effect on the Grand Banks fisheries if you happened to have a spill there. Have you looked into that situation or have you spent any money on it? I am interested because I am a Newfoundlander.

Mr. Winfield: There is a great deal of research being done at the Royal Dutch Shell group on the whole question of marine drilling, and we think in the Shell group today that our experience in marine drilling is probably the best, and we go to enormous lengths to research and develop safe devices so that when we are drilling in the ocean we have good control of the environment.

Senator Hollett: We had a witness here the other day who stated that the oil would have no effect on the fish. You would not say that, would you?

Mr. Bridges: Oh, we would not say that at all. Anybody who said that would be making a great mistake. It all depends on where the oil is spilled, where the fish are, and what kind of oil it is. It also depends on the kind of material used to clear it up. The expense of the Torrey Canyon incident was in the detergent used to clean up the beaches and it was the detergent that killed the fish rather than the oil. We have developed through a lot of expensive experience but at the same time a lot of costly experience how to deal with

these really serious problems. But I would entirely agree with Mr. Winfield that our own drilling practices in Canada—and we were really the pioneers of offshore drilling—have been largely adopted by the federal Government as being the standards for everyone else applying. They have gone into this pretty thoroughly and they feel that we are operating safely.

The Chairman: Honourable senators, we propose adjourning at this time, and at 1.30 we will be here again when we will hear from Liberian Iron Ore Limited and then we will hear McIntyre Porcupine Mines Limited, and then the Committee of British Insurers. So you are going to have an active and alert-requiring afternoon. We will now adjourn.

The committee adjourned until 1:30 p.m.

Upon resuming at 1:30 p.m.

The Chairman: Honourable senators, one brief we have had filed here today is on behalf of the British insurance companies, and is that of an *ad hoc* committee of the British insurance companies dealing with the taxation of non-resident companies that carry on a general insurance business in Canada through branches located here. This is dealing with the question as to what the White Paper proposes to do in relation to their profits. It is a technical brief. The people who are appearing here are perfectly satisfied if we append their brief to our proceedings for today, because Mr. Gilmour will have to interpret it for the committee, in any event. Then, if out of that interpretation, which he will give us maybe at our next meeting or the meeting after that, there are any questions we want to put, we can get in touch with these people and put the questions. Is that agreeable to the committee?

Hon. Senators: Agreed.

Mr. F. W. Pearson, Chairman, Ad Hoc Committee of British Insurers: Thank you, Mr. Chairman. May I record my appreciation and say that we will be very pleased to appear before you or give written advice on any point you wish to raise subsequently.

The Chairman: You understand that even after what Mr. Gilmour tells us, if we still have some questions we will get in touch with you.

Mr. Pearson: We shall be very happy to give any assistance we can.

The Chairman: Then there is a motion to include this brief in our proceedings for today?

Hon. Senators: Agreed.

The Chairman: The first brief we are to hear is on behalf of Liberian Iron Ore Limited, and we have with us Mr. B. Unné, the Vice-President. Mr. Unné is going to commence the proceedings, and possibly in opening, Mr. Unné, you will formally present your panel to the committee?

Mr. B. Unné, Vice-President and Director of Liberian Iron Ore Limited: Yes, sir.

Senator Haig: Before the proceedings start, could the witness tell us where Liberia is? No one else seems to know, so I have to ask the question.

Mr. Unné: Shall I answer right away?

Senator Haig: Whatever you wish.

Mr. Unné: Liberia is a republic on the west coast of Africa, between Guinea and the Ivory Coast.

The Chairman: Mr. Unné, you can now take over.

Mr. Unné: Mr. Chairman, before introducing our group, I would like to thank the committee and its officials for making arrangements for us to appear before you today.

My name is Bertil Unné. I am a director and a vice-president of Liberian Iron Ore Limited, called LIO for short. I am also president of Grangesberg American Corporation of New York, which is a subsidiary of the Swedish Grangesberg Company of Stockholm. The Grangesberg Company of Stockholm is the managing agent of the LAMCO Joint Venture, and also the principal participant in the Swedish LAMCO syndicate, which owns 74.8 per cent of the stock of LIO. LAMCO stands for Liberian American-Swedish Minerals Company of Monrovia, Liberia, which is the operating subsidiary of LIO.

The Chairman: I take it that is a Liberian company?

Mr. Unné: Yes, LAMCO is a Liberian company. Mr. Jan Ekman is Vice-President of Stockholms Enskilda Bank, which is the financial adviser of LAMCO and LIO. Mr. Ekman, who is also secretary-treasurer of LAMCO, will be able to answer questions

about the history, operations, management and financial systems of LIO and LAMCO.

Mr. Nils G. Hornhammar of Stockholm, Sweden, is Tax Counsel to Stockholms Enskilda Bank, and to the members of the Swedish Lamco Syndicate and to other corporations. Mr. Hornhammar specializes in the international aspects of Swedish tax laws, and has written a book in English called "The Tax System in Sweden". Mr. Hornhammar will be glad to answer questions about Swedish-Liberian tax aspects, general practice with respect to international tax treaties, and other arrangements.

Finally there is Mr. Brock F. Clarke of Montreal, who is a director of LIO and the legal adviser to LIO in Canada. Mr. Clarke will answer any questions on Canadian tax aspects.

If you agree, Mr. Chairman, Mr. Clarke will now give you a brief summary of the position of LIO regarding the tax proposals and the modifications suggested by LIO in its submission to your committee.

Mr. B. F. Clarke, Counsel, Liberian Iron Ore Limited: Mr. Chairman, I think I shall start by giving a short summary of what I might describe as background material so that you will know what these companies are, what they do, and a little bit about them, because it has a bearing on the tax effects that are mentioned in the submission.

LAMCO, the company in Liberia, was incorporated in 1955, and was granted a long term concession to explore for iron ore, and if found, to develop mines in Liberia. It was also exempted from all taxes and all duties in Liberia. The Government of Liberia received 50 per cent of the shares of LAMCO. So, in effect, although there was no tax imposed on the company, the Government of Liberia receives 50 per cent of the profits of the company.

The Chairman: And there is also a capital interest of 50 per cent?

Mr. Clarke: That is correct, Mr. Chairman. The other 50 per cent of the shares were issued to private participants who were to finance and provide management to the enterprise.

High grade iron ore was found in the Nimba Mountains at the end of 1955, and funds were advanced by these participants for the engineering and exploring, and also for certain preliminary construction work, and the provision of certain equipment. This group was principally the group that was mentioned as the Swedish LAMCO Syndicate, which is the group in Sweden who have been the principal backers of this enterprise. In the Swedish LAMCO Syndicate the Grangesberg Company is the principal participant.

Now, to provide a vehicle for the holding of the shares of LAMCO held by various private participants, including the Swedish Lamco Syndicate, and in order to provide also a vehicle for the financing of this project and to allow shares to be sold to the public, it was decided to form a company in Canada called Liberian Iron Ore Limited, which we will refer to as LIO. This company was incorporated in Canada in 1958. It was originally intended that this company would raise the capital required for the venture, and Canada was chosen as the place to locate this company for the following reasons: One, Canada had a stable economy and political climate and had suitable tax laws, that is tax laws which made this possible. Secondly, certain potential large lenders of funds would not lend money to borrowers other than those who were located in the United States or Canada. Three, one of the original participants in LAMCO had been a Canadian company based in Vancouver, International African American Corporation. This company I believe is no longer in existence, but these were the reasons which prompted the formation of the company in Canada.

Senator Phillips (Rigaud): Did the latter company referred to in Canada have a direct interest in LAMCO?

Mr. Clarke: No, they were a company which had been originally interested in exploring for minerals in Liberia and really did not have the financial resources to continue the project. They or the Liberian Government were the ones who interested people in Sweden to become interested in this project.

Senator Phillips (Rigaud): Of the 50 per cent equity given to the Swedish content, what portion was given to the Vancouver company?

Mr. Clarke: Originally they had a 25 per cent interest and the Swedish syndicate had a 25 per cent interest in LAMCO. They both put their shares into LIO and the Swedish LAMCO syndicate put in additional funds, so

that they received a larger amount of the original share issue of LIO. Since that time there have been other large injections of funds into LIO by the Swedish syndicate and by public offerings. There are no shares held by IACC as such, because these shares have been distributed. Therefore we do not know how many of them are attributable to the original shareholders, but the Swedish LAMCO syndicate holds just under 75 per cent of the shares now.

Senator Phillips (Rigaud): Would you indicate what the original Canadian background was?

Mr. J. Ekman (Vice-President, Stockholms Enskilda Bank and Secretary-Treasurer, The Liberian American Swedish Minerals Company): There are a number of Canadian shareholders.

Senator Phillips (Rigaud): I do not mean the number, but in terms of percentage of the company. Are we dealing with the problem of foreign investors or with Canadian content as well?

Mr. Clarke: Principally, Mr. Chairman, we are dealing with the foreign investment in relation to LIO, because as far as Canadian shareholders are concerned they really get no present benefit from the company being a foreign business corporation.

Senator Phillips (Rigaud): So we can dismiss the Canadian content as not being relevant to the brief?

Mr. Clarke: That is correct, Mr. Chairman. I just mentioned it as one of the reasons why the company had come to Canada.

Senator Phillips (Rigaud): As you mentioned it, I wanted to get it into perspective.

Mr. Clarke: That is correct, senator. As I mentioned, it was originally thought that the financing would be carried out throught LIO and LIO would borrow the funds, then lending them to LAMCO to provide the very large amount of money that would be required to finance this project. In fact, it was so large that even with the substantial resources of the Swedish LAMCO syndicate it was decided in 1960 to interest Bethlehem Steel Company to take a 25 per cent interest in the project. This was done. I believe they paid an entrance fee of $6 million and received a 25 per cent interest. The LAMCO share of the joint venture, their 75 per cent, was in the process of being arranged, and in fact the prospectus had been filed with the S.E.C. and arrangements had been made with underwriters. The matter was close to conclusion in 1960 when the war broke out in the Congo. This immediately brought all the financing to an end, because lenders were not interested in lending any money that was going to be invested in Africa at that particular time. These were issues that were to be made to the public.

To indicate the type of money that was required, what had to be done was to develop the mine at Nimba. It was necessary to build a railway 167 miles long from the port to the Nimba mountains through jungle, to build a port and port facilities at a place called Buchanan, te build a community where people could live, to develop the mine itself, the roads, crusher, conveyer systems, silos, provide equipment such as trucks, drills, tractors and other equipment, and to build a complete townsite at Nimba where the mine is located. The total cost, including the LAMCO and Bethlehem portion, including interest during contruction, of this first phase, amounted to $225 million.

Since that time, since this original project was built, there have been further investments in a washing and pelletizing plant, completed in late 1967, which, together with other costs incurred to permit greater production from the mine, involved a further investment from both parts of the joint venture of a further $50 million, bringing the total capital cost of the project to $275 million.

The Chairman: Was any of this money raised in Canada?

Mr. Clarke: I will give you a brief description. Bethlehem, of course, supplied their own share, I suppose, out of their own funds. LAMCO's share amounted to $206 million and was financed as follows. LIO and the Swedish LAMCO syndicate supplied $76 million in the form of capital contribution to LAMCO, paid up capital and debentures of LAMCO. In other words, some of the money came to LIO and then to LAMCO; other money was invested directly by the syndicate in the form of debentures of LAMCO. $18.5 million of this total amount was raised by retained earnings of LAMCO; in other words, LAMCO did not distribute that amount of money to enable it to carry on further expenditures. The last item is long term bonds in the amount of $124 million, which were raised by three private

placements: The Kredit Anstalt in Germany supplied $60 million, the Export-Import Bank of Washington, $57.5 million and the First National City Bank of New York, $6.5 million. These are all expressed in U.S. dollars because this was the way the money was raised except for the German interest which was actually raised in Deutsch Marks.

The shares of LIO are owned by 3,000 American and Canadian shareholders and I have not got the breakdown. Mr. Chairman, we could supply that if you required.

There are 2,000 Liberian shareholders. The fact that we have substantial Liberian shareholders is important.

Senator Phillips (Rigaud): May I interrupt. There are 3,000 shareholders between the United States and Canada. May we have a breakdown.

Mr. Clarke: I thought that we gave that information, but if we have not we will supply it to you.

The Chairman: Let us have it as early as possible.

Mr. Clarke: LIO has qualified in Canada since incorporation and is a foreign business corporation and therefore has been exempt from tax, but its shareholders have paid tax on amounts distributed to them by way of dividends. Also there has been some money paid out in the form of interest which has also been subject to withholding tax. LIO does qualify as a company with a degree of Canadian ownership and therefore is subject to the 10 per cent rather than the 15 per cent withholding tax on dividends under present law.

In our written submission on page 7 there is a list of the withholding taxes paid to Canada since the incorporation of the company. The mine came into production in 1963 and the two dividends of 25 cents each were paid. One was paid in 1965 and then we started a quarterly dividend of 25 cents a share in 1966. The company has paid close to $400,000 a year over the last four years.

Senator Hollett: That is altogether?

Mr. Clarke: This is withholding tax that has been paid to the Canadian government each year for the last four years. It has been $400,000 a year since the company was incorporated and it has paid a total of $1,740,000 to the Canadian government.

Senator Phillips (Rigaud): Is the witholding tax on dividends in Sweden similar to that of the United States? I mean the treaty arrangements. The 15 per cent in Sweden is similar to that in the United States.

Mr. Clarke: That is correct.

Senator Laird: In other words, we have a treaty.

Mr. Clarke: There is a treaty between Canada and Sweden, yes.

The Chairman: As I understand it these dividends come from LAMCO which is your Liberian corporation?

Mr. Clarke: Yes, the dividends come from LAMCO, received by LIO and then they are distributed to the shareholders. This company does not accumulate any large surplus.

The Chairman: All the dividend payments do not go to LIO.

Mr. Clarke: We get 50 per cent interest.

The Chairman: Yes.

Mr. Clarke: On our 50 per cent interest, we get the dividend. Of course, the Government of Liberia gets an equivalent amount.

The Chairman: That is right.

Mr. Clarke: Which amount, because they have not paid any taxes, which creates a problem for us under the White Paper, because if we were given a tax credit—I will come to that later—there is no tax as such to be credited to our account, although we really feel that we are more in a partnership arrangement with the Liberian Government than we would be if we were merely paying taxes to them. I will come to that more fully a little later.

In fact, what is happening is that we are paying 50 per cent of our profits to the Liberian Government because they own 50 per cent of the shares. They granted the concession to LAMCO and for that they got these shares.

Now the position will become very different under the White Paper proposals. The problem is that a position of uncertainty will be created.

The Chairman: Roughly, the position is that the White Paper, if implemented, would deny recognition of existing foreign business corporations.

Mr. Clarke: That is correct. That is one effect, Mr. Chairman.

The Chairman: A step was taken earlier by Mr. Fleming when he was the Finance Minister, under which he said that as and from a certain date there could be no more foreign business corporations, but the ones that were then in existence would be permitted to continue, as long as they maintained their status as foreign business corporations.

Mr. Clarke: That is correct, Mr. Chairman.

The Chairman: It may be you should indicate to the committee—they may not all have met personally a foreign business corporation—and perhaps you could just tell them just what kind of an animal it is.

Mr. Clarke: A foreign business corporation was a special status under section 71 of the Income Tax Act, which reproduced essentially the same provisions as the old 4(k) under the Income War Tax Act. So it is not something very recent. It was to permit companies, Canadian resident companies, who carried on no business in Canada other than management—they were allowed to have a bank account and certain housekeeping arrangements in Canada.

The Chairman: Purchase of certain supplies.

Mr. Clarke: Yes, purchase of certain supplies. These companies had to elect each year, to be treated as foreign business corporations. They had to file a return, a T-2 return, making this election and paying a filing fee of $100. They were then treated as tax exempt in Canada. That is, the company itself was exempt from tax.

Now, what Canada could obtain from this was that they could provide the management in some cases; they provided the locale for the company and they also would collect money when distributions were made to shareholders or to lenders of funds.

Therefore, Canada felt it had an interest in encouraging this type of company to locate in Canada, because obviously if they would have been subject to tax, many of these companies would have located elsewhere.

Senator Phillips (Rigaud): Are you suggesting that, in addition to the withholding tax which entered into the residue of the company, that in the so-called 4(k) companies, presently known as foreign corporations, that there would be a bank account payment in Canada which would be regarded as an international stabilizing influence in the treatment of private investment for the expansion of investment resources.

Mr. Clarke: I think, Senator Phillips, it was important for Canada to be involved in the international financial market. Many of these companies are located in areas which are now described as developing countries where, in some cases, the governments were not as stable as in the more developed countries, where the risks involved were greater. It was felt that investors would have more confidence in having a company located in a stable country like Canada. That is from the point of view of people outside the country. But from the point of view of Canada, it made Canada a focus of this international market and, apart from helping lawyers and other professional people, it also was useful to bankers, investment dealers, and other people who naturally do benefit from business created out of this kind of work.

Senator Phillips (Rigaud): Before we break up to report into the Senate chamber, would you regard the status of this now as a stabilizing influence in regard to the value of Canadian dollars in terms of international trade, in terms of balance of payments on the movement of capital into our country?

Mr. Ekman: Sir, I would believe that it would be of interest to a company if it could maintain a volume of this type of business.

Senator Phillips (Rigaud): And to the extent that we had adverse trade balances on overall world trade, the fact that it is a stabilizing influence on the world at large, the movement of capital into Canada would be helpful in terms of the value of the Canadian dollar.

The Chairman: Except, Senator Phillips, most of these foreign business corporations maintain their bank accounts wherever it is most convenient. That was not necessarily in Canada, so if we assume that dividends came to LIO it would not necessarily mean that they came into a bank account in Canada. It would mean only that to the extent there were any distributions to non-resident shareholders, LIO is subject to withholding tax on those items. To the extent that there may have been Canadians receiving, they would receive their dividends, which would be subject to tax. If there were Canadian shareholders, whether they got their dividends in

Canadian or U.S. dollars I do not know. I suppose that would be a matter of choice for LIO.

Mr. Clarke: Certainly to the extent that withholding taxes are paid not only is the contribution to the treasury of the country, but also a contribution to the balance of payments to that extent, because that is money coming in from outside.

Senator Phillips (Rigaud): From the point of view of my colleagues on the committee, I would like to emphasize the point that the issue that justifies our interest in this presentation is not merely the income of $1,740,000, as detailed in the brief, but in addition the stabilizing factor in relationship to the balance of payments problem should further interest us, plus the general problem of Canada being regarded a safe haven for international investors. On this latter point it would be regrettable if we lost that status.

Mr. Clarke: Mr. Chairman, at the adjournment I was about to discuss the effect of the proposals for tax reform on the tax position of LIO. The first and most obvious result is that it will lose its status as a foreign business corporation, and hence would become an ordinary taxable Canadian corporation. At the same time, section 28(1)(d) would be eliminated from the act as such, and there is therefore a possibility that the dividend income received by LIO might be subject to tax. This would be a very serious matter, because in the eyes of the shareholders of LIO, LAMCO, although not actually taxable, is in effect paying half its profits over to the Government of Liberia. By contrast, the subsidiary of Bethlehem Steel in Liberia does not benefit from exemption and pays tax, but the taxes are roughly equivalent to the amount the government would receive if it shared as a partner of that part of the enterprise as well.

Senator Laird: The government has no capital in it?

Mr. Clarke: The government has not contributed any capital. The point I am making though is that these arrangements were made in order to have a closer relationship between the Government of Liberia and the participants in this joint venture. It was done in the light of our knowledge of the situation as it then existed. When I say "our knowledge" I do not mean my knowledge in particular; I am talking about the people who made these arrangements.

If the rules are changed it may not be possible for them to adapt themselves to these changed conditions, and it is possible that these dividends would be subject to tax. It is quite obvious that if these dividends received from LAMCO are subject to tax the position of LIO would be untenable, and the only result to Canada, as far as I can see, would be that this company would be forced to leave the country.

Senator Molson: Is that 50 per cent interest in the name of the Liberian government or in the name of nominees of the Liberian government?

Mr. Clarke: The 50 per cent interest in LAMCO is in the name of the Liberian government. This is 50 per cent of the shares of LAMCO, which is a Liberian company.

Senator Molson: In the name of the Liberian government, not of its nominees?

Mr. Ekman: It is in the name of the government.

Senator Phillips (Rigaud): May I put two questions? Why do you use the expression "possible", Mr. Clarke, because apparently there is some doubt about the White Paper, whether it would be taxable?

Mr. Clarke: The dividends?

Senator Phillips (Rigaud): Yes. Secondly, what is the section of the White Paper to which you would be good enough to draw our attention on that point?

Mr. Clarke: First of all, I say "possible" because there are two provisions in the White Paper, or two possible circumstances. The section with which we are dealing starts at 6.12, on page 73 of the White Paper. It deals with controlled foreign corporations. LAMCO, by definition, is a controlled foreign corporation, because LIO owns more than 25 per cent of the shares. It actually owns 50 per cent of the shares. The reason I said "possible" was that there is one possible exception set forth in the White Paper, which is that if Canada has a bilateral treaty with Liberia—which, of course, does not exist at the present—then the dividends received from LAMCO (that is received by LIO from LAMCO) would be free of tax in the hands of LIO under section 6.15 of the White Paper.

In addition to that—and this is not in the White Paper—the minister, I believe in appearing before another parliamentary com-

mittee, made the suggestion that perhaps dividends received from companies located in developing countries would be treated on a tax-free basis; but this is only a comment and the details of that proposal are not known. That is why I said "possible".

In addition, if we do not come within the provisions, either those contained in the White Paper with respect to treaty countries or those that might be the modifications that may be presented later on as a result of either action taken by the government or recommendations from one of the committees to modify these proposals, then we would come under what they call the tax credit rule, which is that the dividends received from a controlled foreign corporation would be subject to tax initially, but the amount of the tax would be reduced by the amount of taxes paid in the foreign jurisdiction, either by the company from which the dividend was received or by being withheld on dividends that are remitted.

The problem here for LIO is that no taxes are paid by LAMCO in Liberia, even though the equivalent amount actually goes to the government by reason of their 50 per cent interest in the company; and by reason of the concession agreement also no withholding tax is livied in Liberia. So that if there was no treaty and no modification were made to the White Paper proposals, LIO would find itself, as a recipient of dividends from LAMCO, subject to tax at regular rates, which would presumably be in the area of 50 per cent.

The present tax rate paid by LIO, the only tax paid, is the 10 per cent withholding tax when these dividends are paid to foreign nationals. So the total tax rate is 10 per cent of the dividends. That is the total tax collected in Canada considering the dividend as coming in then going out again. Whereas, if a 50 per cent tax was raised and then there were an additional 15 per cent, which is the rate now contemplated by the White Paper—there is no mention in the White Paper of the 10 per cent rate, although there was an intimation that I read in the newspapers that perhaps the 10 per cent might apply, but I think we have to go on the basis of what has been presented—the result of that would be that there would be a further tax of 15 per cent of the remaining 50 per cent, so the total tax rate would be 57 per cent rather than the 10 per cent as at present.

Canada may for some reason wish to terminate the tax treaty with Sweden, because there are certain provisions in the treaty which Canada might not like. For instance, the present treaty provisions, which I would ask Mr. Hornhammar to discuss later, provide that Canada will not impose any capital gains tax on residents of Sweden. This is a normal provision that appears in most international treaties. If Canada wants to impose a capital gains tax on residents of other countries, it will have to renegotiate most or all of their tax treaties, and it takes two to make a bargain. Therefore the rate could conceivably, if Canada did not have a tax treaty with Sweden, be the normal rate cited in the White Paper, which is 25 per cent. This would raise the total tax bill to 62 per cent. It is quite clear that these rates are so high that no matter what advantages LIO and its shareholders may receive from being in Canada, that is the company being resident in Canada and enjoying all that Canadahas to offer in that way, this would be an unconscionably high price to pay for that privilege. As a matter of fact, it is felt that the present amounts being paid to Canada are a fair payment for the benefits received in the form of residence in this country.

Senator Burchill: Does this amount of $1,740,000 represent the 10 per cent withholding tax?

Mr. Clarke: That is right, sir, except for a small amount of interest payments which was subject to 15 per cent tax. That is mostly in the 10 per cent rate.

We are aware that perhaps the rates will go from 10 to 15 per cent and while this is a 50 per cent increase in the amount of tax paid on dividends remitted by LIO to non-resident shareholders this would probably be acceptable, with one exception, which I will go into in more detail later. That deals with dividends paid to Liberian citizens which at present are exempt from tax.

Senator Phillips (Rigaud): Going back to page 7, with respect to your withholding tax from 1961 to 1969 and totalling the amount mentioned therein, my question is have you prepared a schedule or have you material indicating what would have been payable on the format of the White Paper proposals for the said years? I am trying to get to the point to what extent are we changing the rules of the game by inviting your people into this country.

Mr. Clarke: I have not got the total amount of revenue received during the whole of the period. If we can take an average year, while we received about $4 million in revenue from LAMCO we would have had to pay to start with $2 million in ordinary taxes had it not been for the exemptions provided under Canadian tax legislation. This is only because of being of foreign business corporation, but we would also have been exempt under other provisions of the act. Under the White Paper, since there is no treaty with Liberia and assuming that the system was in full operation, all of that income would have been subject to tax. Then, with the remaining $2 million which was paid out we would have been subject to another 15 per cent tax which would have been another $300,000 so that the total tax in a year would have been $2,300,000 instead of $400,000 at the present.

Senator Phillips (Rigaud): Wouldn't it be in order to ask the company to file a schedule supplementary to that indicated in paragraph 7 in order to indicate what would have been the situation on the basis of the proposed White Paper format? I am suggesting this because one of the basic issues with which this committee will have to deal with is the discriminatory aspects, question mark, because we are not including as to retroactivity in relation to this White Paper proposals and the unfairness thereof. I think it would be helpful if we had a comparison.

The Chairman: I suppose if you were going to paraphrase it in the vernacular you might say something like this: what is the fare that the Canadian government is going to charge for international money travel on a route that includes Canada.

Mr. Clarke: I think the answer would be that the amount would be until because it would not be here at all.

The Chairman: That is right.

Mr. Clarke: But, we will supply the information of the amount of taxes that would have been paid had the White Paper proposals been in full effect during this period of 1961 to 1969.

The Chairman: Under your reference to LAMCO and the dividends which the Liberian government receives on 50 per cent of the shares of LAMCO, that does not enter into any calculations of tax position vis-a-vis Canada.

Mr. Clarke: No, it does not, Mr. Chairman, but if LAMCO had gone into Liberia in the normal way and had simply received a concession agreement and had paid taxes in the normal course the government of Liberia would have received 50 per cent of the profits of LAMCO, but it would have received them in the form of taxes and all of the shares of LAMCO on that basis would have been owned by the present LIO or the participants in LIO originally.

The Chairman: This is purely fortitious that Canada got into the act. It just made a choice on the existing situation and the law.

Mr. Clarke: That is right. The choice of Canada was based, as I mentioned earlier, on the laws as they then existed.

Senator Everett: If that situation obtained presumably the White Paper would not affect you.

Mr. Clarke: If instead of being a partner of the Liberian government we were in the same position as the subsidiary of Bethlehem Steel the White Paper would probably have little effect on this particular aspect. Even if there were no treaty we would get credit for the taxes we were paying in Liberia which would represent approximately the amount of taxes that would be executable in Canada. I do not say that it would be exactly that amount because there might be a slight difference. We certainly would be in a much less awkward position then we will be in if these are implemented and we have the arrangements that we now have with the Liberian government.

The Chairman: You can make another decision to move where the climate is more suitable. You have not anything in the way of physical assets or investments that would keep you here. All that would happen is that the public treasury would be short maybe a $1 million or so a year.

Mr. Clarke: Actually we are paying about $400,000 a year. We would hope that this might increase in the future. As a matter of fact, there was an extra dividend paid by LIO of 25 per cent a share authorized by the board yesterday. That was paid in respect of the 1969 earnings, because they had larger earnings than in the previous year. That would increase the amount of withholding tax this year by approximately 25 per cent. In other words, it would add another $100,000 withholding tax.

Senator Molson: Is that extra dividend paid on both A and B shares?

Mr. Clarke: No, this is the shares of LIO which is the Canadian company.

Senator Carter: In your knowledge how many companies like yours are there in Canada? Are you just one special case or are there very many others which are in the same situation?

The Chairman: I can tell you that there are quite a number.

Mr. Clarke: There are less than there were because I know of two that have already left the country since the publication of the White Paper.

Senator Everett: If you were able to make the same arrangements with the Liberian government as subsidiary of Bethlehem Steel has so that the income of LIO was not affected by the White Paper to a great degree, would you still wish to remove LIO from Canada by virtue of the new withholding tax arrangement, LIO's dividends?

Mr. Ekman: The formula under which LAMCO was established in Liberia has been generally called that it was established under the Tubman Formula, that is the open door policy. That was a policy adopted shortly after the last war to encourage investment, foreign investments, in the development of the national resources of that nation. The main principle behind that formula was that partnership with the foreign investor, and to change that in any way would be a monumental change in that principle.

Senator Everett: I agree my question is hypothetical. I am not suggesting you do this. I am saying that if you were able to put your deal on the same basis as LAMCO must do, so that the income from LAMCO would not be affected by the White Paper, as far as it relates to LIO, I am saying, would you still want to move LIO out because of the increased withholding tax on the dividends paid by LIO, under the White Paper?

The Chairman: Mr. Clarke answered that before. He said that even if it went up to 15 per cent, they would not contemplate a move. So I understood.

Mr. Clarke: It has been intimated to me that they might be able to live with the 15 per cent, even though this is a substantially greater amount than the present rate of tax.

Mr. Nils G. Hornhammar, Tax Counsel to Stockholms Enskilda Bank: My own comment on that, as tax advisor to the Swedish shareholders is this. I would say that there are other provisions in the proposals here affecting LIO and the shareholders. Take the capital gains tax proposal, for instance. If we disregard that proposal and just take your situation here, I think we could say, from the Swedish holders' point of view, they could live with that. Then it will be a question of which is the harder—to re-arrange things in Liberia or to incorporate in some other jurisdiction where perhaps there will not even be a withholding tax on dividends flowing from the company to the Swedish shareholders.

Senator Everett: Surely the easier way is to incorporate with some other company.

Mr. Hornhammar: I cannot judge that. I think there are other considerations other than just the tax considerations, that have to be taken into account. But I think it is quite possible, from a taxation point of view to find another jurisdiction, not being a tax haven jurisdiction, but countries like France, The Netherlands and, I would say, also Sweden, for reasons which I may perhaps come back to.

The Chairman: When you were talking about other aspects of the White Paper that might affect the consideration that LIO would give, were you referring to the deemed realization every five years?

Mr. Hornhammar: Yes, sir, that is one aspect. This is a very novel thing. I would have to advise my Swedish clients that I think it is so novel that Sweden would never accept to having a Sweden resident owning stock in a Canadian company, pay capital gains tax to Canada, if he does not have a permanent establishment in Canada. That is the rule under the present treaty. That is the rule, as far as I know, in all treaties, that capital gains be taxed in the country where the residence is. The situation then, I think, would be that of Sweden not wanting to agree on those terms, that the treaty might cease to have effect.

The Chairman: So there may not be a treaty, if the terms in the White Paper continue and affect your LIO operation as indicated here.

Mr. Hornhammar: That would be my conclusion.

Senator Molson: This is regardless of the fact, Mr. Chairman, I assume, that the proposed tax is on unrealized profits and comes up every fifth year?

Mr. Hornhammar: Yes.

Mr. Clarke: I would like to deal now with the four main submissions that we made in our brief. This is on page 10 and following. The text of each submission is put in capital letters, so that it would be more prominently shown.

I think the first I have dealt with at some length already. This is at the bottom of page 10. We feel that these are matters that are essential if LIO is to remain in Canada. Otherwise, its tax position would be such that it just could not remain here and would have to look for another place to go.

The first is:

> Dividends received by LIO from the Liberian American-Swedish Minerals Company (LAMCO) should be exempt from Tax in the hands of LIO, either by Canada entering into a bilateral tax treaty with Liberia, or by allowing dividends from companies established in developing countries including Liberia to be received tax free by Canadian companies or, preferably, both.

Now, the problem that arises with respect to a tax treaty, and I think it arises from Mr. Hornhammar has said, is that it is not going to be easy for Canada to negotiate treaties or terms satisfactory to it, which fit in with these proposals in the White Paper. For instance, to permit this five-year revaluation for capital gains tax purposes.

Under most treaties, under the normal rules applying to treaties, no capital gains taxes are exigible at all by the other country, that is, the country other the residence of the taxpayer, unless the taxpayer has a permanent establishment in that other country. This is the normal rule in international agreements.

Now we want to do something and we will have to do something quite different from that, if we are going to implement the provisions in the White Paper. Mr. Hornhammar would like to add something.

Mr. Hornhammar: On the question of how long a time it would take for Canada either to renegotiate its present tax treaties or to conclude new treaties with a new content, if I were to advise my Swedish clients, I would have to say that, in the Swedish experience, Sweden today has a network of more than 35 treaties, including some 10 or 12 treaties with the developing countries. It takes a terribly long time to conclude a tax treaty, at times. As far as I know, today Canada does not have any tax treaties with any developing countries. The developing country today will ask certain provisions be entered into the tax treaty which are different from those that you have in treaties with the developed countries. They will ask, for example, that a tax-sparing provision be introduced, and tax-sparing means that, if the developing country allows exemption from its internal tax on a particular income, the country where the recipient is will allow, as a credit against its tax on the income, an amount equal to the tax forgiven in the other country.

If Canada is willing to enter into treaties containing such similar provisions, then it might not be too hard. However, in general it is our impression in the Swedish experience that it takes a lot of time before a treaty is concluded. Therefore, one cannot rely on Canada having a treaty with Liberia within two or three years.

Mr. Clarke: This raises a problem for the shareholders of LIO, because they will then have moved into the new system without knowing whether they are going to be able to live with it for an indefinite period of time. You might say, well, in the meantime they are not subject to tax, because they have this five year period that has been mentioned in the White Paper, where the present rules will be continued in effect. However, the shareholders, and that affects principally the principal shareholder, would find themselves in the position that if they decided to remove themselves let us say after two or three years because no treaty could be entered into and they were coming to the end of the road under the present rules where the company would be wound up and, let us say, they were deemed to receive a greater amount than the value on valuation day, then they would be subject to capital gains tax in Canada unless they were protected by the Swedish treaty. There would be so many uncertainties that perhaps they would choose to make other arrangements before the axe fell.

This is something that Mr. Hornhammar is intimating to the committee, although he is not saying it in so many words. We have to recognize that uncertainty about these things

can be just as damaging as adverse consequences when realized. This is very important for the committee to appreciate. I am a lawyer in Canada and we practitioners are asked for advice by Canadian clients, but also by international clients, that is clients who are outside Canada. They are bothered just as much by this uncertainty in many ways, and take action on it. We have had clients who have taken action because they say we just cannot wait to find out; we are going to take measures now, when we know the situation. Sometimes they solve the problems by leaving the country, which is damaging to Canada because, as I said earlier, there are benefits to Canada in having these companies located here.

The second item we wish to deal with is the question of passive income. This is dealt with in the White Paper in paragraph 6.20, on page 74. The information given in the White Paper is by no means complete. In other words, it refers to the American system without explaining what that is. As many of you may know, the American system is very complicated. I believe it takes about 70 pages of the Internal Revenue Code of the United States to explain sub-part (f). I am told by practitioners in the United States that these provisions are very difficult to interpret and often difficult to apply. I did not know what passive income was until I read the White Paper, but apparently it is such things as dividends, interest, royalties and trans-shipment profits. That is not necessarily the full list, but those are examples of it which are given in paragraph 6.20.

Our problem is that we realize that passive income can give rise to at least postponement of tax if retained by a foreign corporation. However, the point that we wish to make is that LAMCO, as an operating company in Liberia, is bound at times to have excess funds. At the present time it happens not to have excess funds and has a line of credit from the bank. However, it would prefer to be in a position where it had from time to time excess funds. Funds are needed to be put aside from time to time to provide for future capital expenditures, sinking fund payments of debts, contingencies and to iron out the ups and downs in the economic benefits received by the company so as to maintain an even flow of dividends.

There are many reasons why companies in the normal course of business—I am not talking about taking advantage of the situation—must put aside funds which are temporarily available for investment. These funds are not just going to be left there; they are going to be invested, probably in short term securities, and some return will be received by LAMCO. If LIO is to keep very careful track of these funds and is taxable on its share of any income that might come to LAMCO in the form of, for example, interest on excess funds that are available to us from time to time, it is going to put a very serious burden on LIO as the shareholder, because it will be taxed on income that it has not received. In fact, it will be taxed on income which, if it had been ordinary operating income, would not have been subject to tax. This is assuming that suitable arrangements are made under item 1 that is the dividends from LAMCO as the subsidiary of LIO would be received tax free. All that we say is that we think the rules should not be too rigid in this regard. Some latitude should be given for a certain amount of passive income to be received by operating companies. However, this should not be done in a way that will unconscionably take advantage of the foreign jurisdiction to receive tax free income that would normally be subject to tax received directly in Canada.

We submit that there are many instances where it would be quite reasonable to invest funds and even substantial amounts of funds when you take into account the size of the project involved here. You might have to put funds aside, for instance, if you were going to put in a new crusher or conveyer. These things cost millions of dollars and we do not just decide at the last minute that we are going to raise the money somehow or other. This money must be put aside to provide for the future.

Senator Molson: Mr. Chairman, in connection with this part on passive income, could I ask what the reason for that form of taxation has been? Perhaps Mr. Gilmour might speak to it. The United States, I assume, were trying to force through money on account of balance of payments. There must have been some reason for this taxation in the hands of the subsidiary of passive income. I would like to know the background. I am wondering why the White Paper has gone for this system which, obviously, has so many complications and perhaps a good many undesirable qualities.

The Chairman: In paragraph 6.20 they attempt to give an explanation.

Senator Molson: I read it, Mr. Chairman. I am afraid I still have to ask the question.

Mr. Gilmour: Senator Molson, the history of the foreign business corporation is a very old one in Canada. Undoubtedly back in the 'thirties it was created at a time when Canada was holding itself out as a tax haven to assist the residents of other countries. Looking at our tax history over the years, it is found that as far back as 1936 we took a private investment holding company owned by a non-resident, and at that time divided our tax act into what we called section 4K companies, that ultimately became foreign business corporations, and non-resident owned investment coroprations.

The dividing line as far back as 1936 was essentially that the 4K or foreign business corporation had to carry on an active commercial, industrial or public utility business, and it had to carry it on entirely outside of Canada. We therefore tried to get away from this phrase "passive income", which essentially is income from portfolio investments, and tried to say that the passive income type of operation would be an NRO. The NRO, as we heard a week or two ago, is an attempt to enable the non-resident to hold Canadian securities through a Canadian corporation, but not be out of pocket any more Canadian tax than if he had held directly.

Meantime, our foreign business corporations developed, in that we insisted, first that it be an actual operating company. Then there was a strange paragraph that appeared that this operating company, whose shares had to be listed or offered for public subscription, could carry on the business itself, or alternatively could carry it on through wholly owned subsidiaries or affiliates, so that our foreign business corporation concept gradually widened to that as long as you carried on a business, an active business, yourself or through a foreign subsidiary, in either case that income would be exempt from tax.

Back in the 'sixties, in the days of Mr. Fleming, the old stigma of tax evasion had still stuck tc the foreign business corporation, and he passed a law that the numbers would be frozen. All he said was that if you failed to maintain your status after a date in the 'sixties you would then become subject to the normal taxes. That meant, of course, that the passive income from a foreign subsidiary of a foreign business corporation would escape Canadian taxation, because we have the rule about owning more than 25 per cent, so that we continued giving exemption to the passive income.

When Fleming froze the numbers, quite a few of these companies anticipated what might be called the writing on the wall, and although I would say that since the 'thirties these companies have not been used to avoid or evade Canadian taxes, they have been a source of revenue, as these gentlemen have pointed out, almost exclusively through the withholding taxes. Many people in the 'sixties decided to withdraw. Many is the time in commercial practice that we said, "You are silly to have a Canadian foreign business corporation with all the potential tax problems. Why don't you go to Bermuda and do the same thing, and you won't have the withholding tax and you won't have the worry."

After these companies became frozen, there was a great rush by United States parent companies to buy up a charter of a foreign business corporation in good standing, and some pretty fantastic prices were paid for these charters in good standing, because they were a device that enabled an American parent to defer its United States taxes through the use of such a corporation.

Our White Paper seems to have the feeling that was expressed so delightfully by the Shell representatives, that Canada is acting as a policeman for the tax systems of other countries. I know our Finance Department says that we must get rid of NROs or foreign business corporations because other countries do not like them, and that seems to be an underlying theory. When that statement is analyzed, I do not think it holds water, but that has been the thinking. Our proposal today is that we will phase these things out because they are improper, and we phase them out by first looking to the so-called passive income, that is the dividends received from the underlying subsidiaries.

Then, of course, on the actual operating income, if these companies are foolish enough to stay in Canada and have operating income in, say, Central America or some other place, then ultimately that too will be taxed. The net result, of course, will be, as these gentlemen have said, that with one or two exceptions—probably the major exception in Canada will be the old Brazilian Traction; it was essentially a Canadian company; it will be foolish if it stays in Canada; it may not be able to move easily, but it will be foolish if it

stays here; it can do other things; and there was the International Power and other utilities as you know—the net result of all this will be that probably without exception these companies will not pay tax to Canada; they will simply pay no more tax, and probably cease to pay the withholding tax. This desirable result if I can call it that, is so that we can increase our stature as the policeman for the international community.

The Chairman: Continue, Mr. Clarke.

Mr. Clarke: The next point that we made is one that perhaps has particular application to this company and I imagine to other companies in the international field who have similar problems. We are requesting that dividends of LIO to Liberian citizens be exempt from non-resident tax. Under section 107 of the Income Tax Act dividends paid by LIO to Liberian citizens is exempt from tax, but section 107 deals with a particular kind of company. In order to get the benefit of that section the company must be a foreign business corporation. The White Paper is silent on this provision. Obviously if there are no foreign business corporations and the White Paper says there will not be any in the future, if these proposals are implemented, then unless section 107 is modified in some respect it could not be applicable in the future. The importance of this is simply that here you have a company, LAMCO, operating in Liberia and the only way a Liberian citizen, that is an individual or a company other than the government may participate in LAMCO is by owning shares of the holding company, LIO.

When shareholders in Liberia received dividends from LIO and they found that they had paid tax to the Canadian government on money that really came from their own country, which was really just passing back to them, they were quite incensed about it. While technically I suppose it was something that was quite reasonable for Canada to do without knowing more about it, it is quite understandable why they reacted in this way. What happened was that there was a provision in the act, section 107, and it applied only to a foreign business corporation which was in the public utility business. It had obviously been put in the act because of the situation of Brazilian Traction and some other public utilities, such as the International Utilities which was mentioned.

We approached the government of Canada. That is not only LIO, but in conjunction with the government of Liberia. I came to Ottawa with Mr. Weeks—he is now the secretary of the treasury of Liberia but he was then in another cabinet post—to make representations on behalf of LIO and the Liberian government. As a result, that section 107 was amended to include companies which were in the business of extracting and transporting ore.

The amount of money involved is not very large. Although there are a large number of shareholders in Liberia most of them are very small. That is, each one of them holds a very small number of shares. The amount of money involved is not going to be great, but you can understand that the political impact is very important and it is a matter of serious concern to LIO and to its shareholders that the revenue should continue to be given for dividends paid to citizens or residents of Liberia. We would request that in implementing the White Paper that section 107 of the act be amended so that the exemptions from tax on dividends paid to Liberian residents continue as at present.

The Chairman: I suppose instead of saying a foreign business corporation you could describe it by what it does.

Mr. Clarke: Yes, I think the rule was put in because—this particular situation did not apply to most other companies.

Senator Burchill: How long has that been effective?

Mr. Clarke: I do not know when the amendment came in, possibly 1966 or 1967. I believe that the section, however, has been in the act certainly since 1948 and probably prior to that.

Senator Burchill: The amendment came in in 1966?

Mr. Clarke: That is correct. The amendment only dealt with extending the type of foreign business corporation. Before that it only applied to public utilities. Our company was not a public utility. In order to have this section apply to LIO it was necessary to amend the act to include companies engaged in the business that LIO is engaged in through its subsidiary, LAMCO.

Senator Haig: In what currency are these dividends paid?

Mr. Clarke: In United States funds, senator.

The fourth item of our submission reads this way:

> Sale of LIO shares by non-resident shareholders having a substantial interest should be free of Canadian capital gains tax. In any event, no tax should be levied on an arbitrary five year revaluation basis.

Senator Laird: Why confine it to shareholders of substantial interest?

Mr. Clarke: The reason is that shareholders having less than a 25 per cent interest are considered to be holders of a portfolio investment and under the tax proposals would not be subject to capital gains tax. That is in the White Paper itself. It is only the Swedish LAMCO syndicate, the majority shareholders involved which are in this tax treatment. That is the only company that is involved and they are at present protected by article XIV of the schedule to the 1951 Canada-Sweden Income Tax Agreement.

Senator Phillips (Rigaud): Swedish and U.S. shareholders, which you referred to earlier in respect of capital gains, leaving out deemed-to-be revaluation, are presently protected under the treaty?

Mr. Clarke: They are presently protected under the treaty, Senator Phillips, as long as the treaties remain in effect. They then have nothing to fear, but on the other hand it seems to us that if proposals are put forward it is intended that they will be given effect to. Most of the investments in Canada are made from people in treaty companies such as the United Kingdom, the United States, Sweden and so on. Therefore, the suggested provision in the White Paper would have little or no effect unless Canada intended to renegotiate these treaties which we recognize will be a very difficult thing because we are going away from what is the normal content of an international treaty. We can only assume that it is the intention of the government to do that, otherwise I do not know why they would have made such a proposal in the White Paper.

We are anticipating they will try to renegotiate these provisions in the treaties, otherwise, if the treaty remains in effect then of course we would not be subject to tax. That is, the Swedish LAMCO syndicate would not be subject to tax in respect of the realization of a capital gains. The situation seems to be a little less clear about this arbitrary evaluation because the provisions of the treaty do not seem to have contemplated anything of that kind and therefore they do not talk about deemed realizations but realization on sale or disposal.

Senator Phillips (Rigaud): May I put a question to the chairman? Is it to be taken that we are to understand that, in the final analysis, we have Sweden and Liberia, we have the Liberian Government and we have the Canadian shareholders. There were those who came to Canada and were the non-resident interest from the Canadian standpoint. They were subject to a withholding tax, I suppose, without being in your schedule on page 7 of your brief?

Mr. Clarke: That is correct.

Senator Phillips (Rigaud): Under the proposed terms of the White Paper, the rules change, and all that Canada does, in the requirement for a particular set up, is that it gets you a legal holding, and for that legal holding Canada charges you a withholding tax of 10 per cent, irrespective of the movement of dividends.

Mr. Clarke: That is correct.

Senator Phillips (Rigaud): Am I quite correct?

Mr. Clarke: Quite correct.

Senator Phillips (Rigaud): If I understand your representations and if I follow them correctly—leaving out the formal aspects of my personal point of view, and not now speaking for my colleagues, on retroactive legislation, leaving that aside—do I understand the net effect of your representation to be that, in return for this legal home that you have for LIO, you cannot see why Canada is entitled, in terms of revenue, other than to a reasonable revenue relating to withholding tax on dividends?

Mr. Clarke: That is correct. Is that not so, Mr. Ekman?

Mr. Ekman: Yes, I think that is a correct summing up of the situation. Of course, it would be a vital change to us, compared to the situation when this was originally set up.

Senator Phillips (Rigaud): As I see the situation of this particular committee, and of course I am only speaking as an individual, we still hold that we have a character and quality in the world at large. As I see it, the

point is that if there is a setup for a company such as LIO, all that Canada does is allow them to form such a corporation and to route dividends where there is no Canadian revenue in terms of withholding tax.

Mr. Ekman: That is correct.

Senator Phillips (Rigaud): Plus what I have said previously, in respect of balance of payments, and insistence on a stability that was offered, and so on. I am trying to be a catalyst, so to speak, to see whether that is the basic effect of the representation.

The Chairman: It would appear to be so, to me.

Senator Phillips (Rigaud): Thank you.

The Chairman: Are there any other representations you wish to make, or any member of your panel?

Senator Hollett: Before you pass on, could I ask how the recommendations made in this brief will affect, say, Iron Ore Mining Company in Labrador?

The Chairman: I do not know. They have indicated they are going to present a brief.

Senator Hollett: I see.

The Chairman: And they indicated—I think it was in the newspapers that if the White Paper provisions were implemented they would not be able to go ahead with their expansion, which includes, I believe, the facilities for pelletizing and therefore they would, in an economic way, run out of marketable ore within a certain period of time.

Senator Hollett: What I mean is, if these concessions are granted to this company, it would not affect them?

The Chairman: No, because the iron ore, I assume, that is produced in Liberia finds its market in various places in the world.

Mr. Unné: Yes.

The Chairman: I suppose that in the world markets it might be a competitor with Iron Ore of Canada. I do not know.

Mr. Clarke: In the sense that it is an international commodity, I suppose that it does have a competitive effect; but, regardless of what decision is made by Canada, the competition that exists will continue to exist and will be no greater and no less.

Senator Phillips (Rigaud): That is a matter of fiscal policy in relation to the country, it is not related to the tax.

Mr. Clarke: That is right.

The Chairman: Is there anything else?

Senator Everett: On the first item in your brief, LIO stated that they located in Canada originally in contemplation that Canada would be used as a financing vehicle directed towards the South American market. I have two questions. One is, was that your only reason for locating in Canada or were there other reasons; and, two, if that reason could not be or was not acted upon, why did you continue to stay in Canada—and I am talking about the time prior to the White Paper proposals?

Mr. Clarke: I mentioned earlier this afternoon that there were really three reasons for coming to Canada originally. One was the stable economic and political climate, together with the tax laws that permitted LIO to come here.

The second was that which you have just mentioned, senator, which really involved LIO issuing securities, really in the American market, because that is where it was proposed to raise money, and certain of the borrowers who had been contacted would not lend money unless it was to a company located either in the United States or in Canada.

The third reason was that among the original participants—this is of historical interest only—in LAMCO, the operating company in Liberia, there was a Canadian company called International African American Corporation, which has since been wound up and the shares it held in LIO have been distributed to its own shareholders.

Those are the historical reasons why this company was incorporated in Canada.

Now, why did it not move? It did not move because it was quite prepared to pay the tariff of 10 per cent withholding tax in order to enjoy this. This holding company had to be put somewhere. When you have an international operation, there must be somewhere where the holding company is located. It could have been located in Liberia itself. However, this might have made it more difficult to issue shares. Some shareholders just thought the fact that this company was located in Africa might have caused them some concern. They would prefer to have a compa-

ny which was located in Canada or in some other stable country and more developed country.

Senator Everett: Why not Sweden?

The Chairman: You said it could have been Sweden.

Mr. Clarke: At that time there was no treaty between Liberia and Sweden. There is now, incidentally. Sweden was one of the alternatives mentioned by Mr. Hornhammar earlier this afternoon as a place where this company might relocate—not the same company, but a re-organized company—if forced to leave Canada. But you will appreciate that this is a company with a large number of shareholders, it is listed on the Toronto Stock Exchange, and it has developed a certain standing in the international community. It is not desirable to move, if this can be avoided; but if the White Paper proposals are implemented in full, and if the results are those that are indicated in our submission, and if the relief requested is not forthcoming—without wishing to be threatening or anything like that, I think it is just a question of fact, that they would have to leave, because they just could not afford to live under those rules.

Is that a fair summation, Mr. Ekman?

Mr. Ekman: Yes, that is the situation.

The Chairman: Is there anything further Mr. Clarke?

Mr. Clarke: No, Mr. Chairman, except to thank you and the members of your committee for your patience in listening to us.

The Chairman: That is part of our job. We have enjoyed your presentation and I think we understand it.

The Chairman: Honourable senators, we have one more brief, McIntyre Porcupine Mines Limited.

Senator Molson: What about the insurance companies?

The Chairman: That was dealt with while you were absent. They requested that their brief be taken into the proceedings today as they felt their point was technical. Mr. Gilmour was requested to advise them of any questions we may have and if necessary we will be in communication with them.

We have Mr. Godin, Mr. Goodeve and Mr. Plaxton.

Mr. J. K. Godin, President, McIntyre Porcupine Mines Limited: Mr. Chairman and gentlemen, we should like to express our appreciation to this committee for having received our brief on the White Paper on Taxation and for allowing us to elaborate on it. I have been in the mining business in Canada for the past 27 years, being mainly concerned with exploration, development and production of minerals. I am genuinely concerned about the adverse effects which adoption of the White Paper proposals would have on the industry and in fact on the whole Canadian economy.

The substantial growth of the Canadian mining industry has been largely due to the tax incentives which have kept the Canadian mining industry competitive with other major mining countries such as Australia and the United States. Loss of these incentives, coupled with implementation of certain other proposals in the White Paper, would seriously affect the future of the industry. The adverse effects of mining exploration in Canada would be immediate and serious. Canada has been relatively well prospected and mines are becoming more difficult and costly to find. There are other countries less well explored and geologically available, which would now offer a more favourable tax rate and a correspondingly higher return on investment. McIntyre, like most other Canadian mining companies, has set up exploration offices in various parts of the world and is in a position to take advantage of mining opportunities wherever they may occur. The company has allocated 42 per cent of its 1970 exploration budget to areas outside Canada.

Turning to development, if any Canadian company is fortunate enough to discover an outline of mineralized zone which is potentially an orebody, one of the most important factors in the decision whether or not the discovery should be developed is the length of payback of the money invested and the return on that investment. Removal of the incentives would in many cases reduce the rate of return below the acceptable minimum. Our Madeleine mine is a case in point. This is a relatively low grade copper mine in the Gaspé area of Quebec. Ore reserves as could be determined from surface were not large. If the White Paper proposals had been in effect at the time the production decision was made, this decision would have been in the negative

and the substantial contribution that this mine will make to the economy of a depressed area would have been lost.

Many Canadian orebodies are small and marginal in grade, but they always have the potential of developing into larger, longer lived and more profitable operations than is initially indicated. Present tax legislation has provided the opportunity for mining companies to gamble on the development of these. In McIntyre's case we gambled on the Lorraine mine in northwestern Quebec and unfortunately lost, as the orebody proved limited. Without the three year taxfree period we would not tave made this attempt. It is well known that the original Noranda mine had very limited reserves. It was only after successful exploration following the decision to go ahead that the large reserves were proven. Two years ago our company decided to proceed with the development of metallurgical coal properties in northwestern Alberta. This decision was made after an expenditure of about $4 million to assess the potential of the property. Since then over $50 million has been invested in mine development plant, unit trains, new town site, and other facilities. Present plans call for production of 2 million tons per year. We have very large reserves capable of future expansion. In the past year the demand for metallurgical coal has increased enormously.

The Chairman: What is metallurgical coal? I am ignorant of it.

Mr. Godin: It is used in the production of steel, rather than burning for power. There is also quite a difference in price.

The Chairman: I would think so.

Mr. Godin: Our principal competitors for this market are the eastern United States producers, with whom we are at a disadvantage because of the more generous United States depletion allowance, which gives them an after tax advantage estimated at 40 cents per ton. Our present depletion allowance, which the White Paper does not propose to change, is completely inadequate.

With respect to our intercompany dividends, for the past ten years the major part of our income has been dividends from investment in other Canadian companies. At the present time these are not taxed. Under the White Paper proposals such dividends will be taxable, to the extent that the payor company is able to reduce its tax liability through depletion and other tax allowances. In other words, the tax saving to the payor becomes additional tax to the payee. This is illustrated in Exhibit 3 which we provided.

With respect to capital gains, we are not convinced that any form of this tax is appropriate at this stage of Canada's development. However, the proposed tax on unrealized gains would have cost McIntyre an additional $71 million of taxes over the past ten years. This exceeds our earnings for that period by $10 million. This, you will agree, would have been an impossible situation.

To sum up, Canada has no monopoly on the natural resources of the world. Due to the great advances made in bulk transportation by rail and sea, world competition is much keener. Removal of incentives to the mining industry would rule us out of competition in some areas. With regard to the proposed changes in personal income tax rates, we are now at a disadvantage compared to the United States. There is no doubt in my mind that widening the gap will mean the loss of many technical people, which the mining industry can ill afford.

Mr. Chairman, this sums up our brief. My colleagues are Mr. George Goodeve, company treasurer and chief financial officer, and Mr. Plaxton, our chief geologist and assistant to the president. I hope we will be able to answer any questions you and your committee have.

The Chairman: Mr. Godin, let us look for a minute at the statement that has been distributed, exhibits 1 and 2. You suggest that if the White Paper proposals on taxing unrealized gains had been in effect in the last 10 years your pay-out in relation to that deemed-to-be realized gain would amount to $71 million.

Mr. Godin: That is right.

The Chairman: That would be a liability of, I suppose, McIntyre in this case, because it operates through subsidiaries and holds the shares of those subsidiaries.

Mr. Godin: Our major income in the last 10 years has been dividend income.

Mr. A. G. Goodeve, Treasurer, McIntyre Porcupine Mines Limited: This capital gain relates only to capital risk, which is 80 per cent.

The Chairman: What is the position of McIntyre in relation to facing a liability of this kind, assuming it continues to hold Falconbridge every five years?

Mr. Godin: What would happen in the future?

The Chairman: Where would the money come from?

Mr. Godin: Well, that is a pretty good question. Would you like to answer it, George?

Mr. Goodeve: I do not think we can afford to be in this position.

The Chairman: I asked Mr. Bryce this question when he was here and he suggested that if there were not any other sources you might borrow it. Would you care to comment on that?

Mr. Goodeve: I do not think that is a reasonable alternative either, because presumably you reach the point of diminishing returns where your tax exceeds your earnings and eventually you disappear. It seems to me that the only alternatives open to McIntyre are either to merge with Falconbridge, distribute the Falconbridge shares to its shareholders, sell the Falconbridge shares, or possibly transfer the investment befor the capital gains tax comes into effect to a U.S. subsidiary company.

The Chairman: If you took either of those courses, what would be the effect on the White Paper proposals as to any realization that they hope to get from the proposals? I take it when you speak of transferring the investment in Falconbridge to a non-resident company, the designed effect of that would be to avoid tax, is that right?

Mr. Goodeve: Yes, sir.

The Chairman: Then if it were successful, this particular capital gains tax would not provide any revenue for Canada?

Mr. Godin: That is right.

The Chairman: What would be the disadvantages to Canada in such event?

Mr. Godin: I would say a loss of income.

Mr. Goodeve: I do not think there would be any disadvantage to Canada really.

The Chairman: If the shares were held by a non-resident company you would withhold the tax?

Mr. Goodeve: Yes.

The Chairman: The shareholders would be non-resident, I assume?

Mr. Goodeve: Yes.

The Chairman: Therefore, there would be no personal income tax, only the 15 per cent.

Mr. Goodeve: Only the 15 per cent.

The Chairman: So to the extent that there was any element of personal income tax involved, that would disappear?

Mr. Goodeve: Yes.

The Chairman: And even to the extent of any corporate tax on the income from those shares, that would disappear?

Mr. Goodeve: That would disappear also.

The Chairman: So over all there would be a loss of tax revenue greater than the gain by way of withholding tax?

Mr. Goodeve: Yes, sir, unless you are comparing it with the present tax rules, where I do not think there would be any loss of revenue.

The Chairman: What do you mean by that? Let us assume you did it now. Is this what you mean?

Mr. Goodeve: If we did it now, absolutely.

The Chairman: You say the Canadian tax revenues would not suffer?

Mr. Goodeve: I do not believe the Canadian tax revenues would suffer if we did it now.

The Chairman: And if you did it after the White Paper provisions that you were referring to were implemented?

Mr. Goodeve: Then there would be a great loss of personal income tax on this grossing up procedure. I think that is perhaps illustrated in our exhibit 3, which is intended really to illustrate the effect of depletion on dividends. There is a note at the bottom which says that a non-resident pays only 15 per cent Canadian tax on his incremental income which applies also on any dividends, whereas on the proposed integration of personal and corporate taxes, residents would be subject to an effective tax rate in this instance of 25 per cent.

The Chairman: Yes.

Mr. Godin: Am I correct?

The Chairman: Yes, you are correct.

Mr. Godin: So there would be a reduction in tax there.

The Chairman: So there would be a reduction in tax revenue, yes.

Mr. Godin: Yes, sir, under the White Paper proposals.

The Chairman: Yes.

Senator Aseltine: I understand, Mr. Chairman, that if these proposals go into effect this company will have to pay $71 million on unrealized capital gains.

Mr. Godin: That would have been the situation over the past ten years.

Senator Aseltine: Would they be liable for that? I thought we were going to have a revaluation day.

The Chairman: Senator, this is prepared on the basis that one assumes the proposals in the White Paper have been in effect over the period of the last ten years.

Senator Aseltine: That is different, then.

The Chairman: That is the assumption, and exhibit 1 shows the actual situation for that period. It shows the difference between the two situations would have been $71 million of additional tax liability.

Now, Mr. Godin, I was wondering whether you had some particular comment to make on tax holiday and on depletion, in addition to what you said in your summary.

Mr. Godin: As I mentioned, if a property is brought to us or developed to a certain point and we put it into production, then one of the major factors that we look at is the amount of money required to put it into production. We look at the rate of return on that investment, and in our table in our brief we have shown that. In many cases the rate of return would be just unacceptable if the proposals in the White Paper with respect to the tax-free period and depletion allowances were followed.

The Chairman: But isn't there another factor? Hasn't the money market become accustomed to, and doesn't it dictate terms based on, as quick a pay-out as possible? And you do attract capital because of the tax holiday and the depletion.

Mr. Godin: That is correct, in that it follows through that the tax holiday and the depletion allowance in many cases are an acceptable return on investment which is acceptable to us, if we are using our own money, or to the banks if we are going to borrow money, or to others if we are doing to raise it.

The Chairman: Then so far as new developments are concerned in respect of mining I take it that your evidence is that without the tax holiday and with the proposed depletion allowances there would have to be a new educational program for financing such risky ventures as developing a mining property.

Mr. Godin: That is possible. It is certainly very definite that under the new proposals certain mineralized zones, and I refer to them that way because they are not ore bodies until they are mined, would never be developed. They would certainly never be developed by mining companies. The rate of return is just not there.

Senator Phillips (Rigaud): Mr. Godin, we were told by the Noranda Company when it presented its brief that the publication of the White Paper had already had the effect of slowing-down exploration activity and had made it more difficult for mining companies generally to obtain proper financing. Would you concur in or dissent from that observation?

Mr. Godin: I would agree with that, senator.

Senator Phillips (Rigaud): You would agree?

Mr. Godin: Very definitely. Whether or not the White Paper is implemented, there has already been a period of uncertainty resulting from its proposals, and this uncertainty affects decisions in many cases.

The Chairman: We were told by Noranda as well, Mr. Godin, that if they have to make a choice as between taking the tax holiday and taking depletion that they would prefer to take depletion because it meant more to them. Have you any comment on that?

Mr. Godin: In general the tax free period is preferable if the reserves are low and the life is short. If you are fortunate enough to have

indicated large reserves initially then the depletion becomes more important.

The Chairman: It is a matter of what it is you are developing.

Mr. Godin: That is right.

The Chairman: Would you take the position that both incentives are necessary and should be available?

Mr. Godin: Yes, I think they go together and compliment each other.

The Chairman: Not by election or alternatively.

Mr. Godin: Are you saying that if we had a choice which one would we prefer?

The Chairman: Noranda expressed that they would prefer the depletion. Is that the way the law should be written or should both incentives be available?

Mr. Godin: I do not suppose that Noranda said that they would prefer any depletion. It would have to be of a certain amount. It would not be a 10 per cent depletion.

The Chairman: The presently existing depletion.

Mr. Goodeve: We think this question of depletion and the exemption is strictly a formula by which the amount of tax is calculated and the amount of tax we are interested in, such as our take home pay. We also think that it has a great bearing on the financing and the degree of profitability of any project, because it either makes it easier or more difficult to finance. The message we are trying to get across in our brief, whatever the formula, is that we hope the rate of return on investments generally is not reduced because it makes it more difficult for us to compete with other countries. In essence, that is the whole of our arguments on incentives.

The Chairman: Judging from the figures which Noranda produced they showed that their incident of tax would be substantially larger if they were operating under the White Paper as against their actual operations. I take it that is your position also.

Mr. Goodeve: Yes. On page 5 of our brief we have it tabled rather simply to Noranda as a matter of fact.

Senator Phillips (Rigaud): Mr. Godin, on page 1 of the brief there is a very interesting paragraph and I shall quote:

> In our opinion the White Paper has singled out the mining industry for unduly harsh treatment and we recommend that the Government should reconsider the proposals relating to mining so that its tremendous contribution to the Canadian economy will not be impaired.

You then refer to the report of the Economic Council which reflects that observation. Some of the important companies and you are an important one have, in addition to being critical, suggested alternative methods of treatment of relief. We noticed, or at least I noticed, that your paper joins other companies, such as oil companies and resource companies in being critical on the dimunition of the incentives to the extent it is becoming possibly catastrophic. We do not notice any alternative suggestions, at least I don't. Is there any reason why you do not do so or are we to infer therefrom that you are suggesting that this committee recommend that we adhere to the present incentive rates?

Mr. Godin: The present incentive rates have been very successful in allowing the industry in Canada to develop to the point where it is. It is the third largest in the world. In my opinion why change them. They have been tried and proven.

On the other hand, the reason we have not got into this detail is that a brief is being presented, as you probably know, in this committee and the Commons Committee by the Mining Association of Canada. If we brought up the same arguments it would be repetitious. It would be the same thing. It would just be a repetition of possible alternatives.

The Chairman: So that this is a preview indicating the particular position of McIntyre and how it is affected, but the general development and what is the effect of incentives and how they are needed in mining operations generally will be developed in the brief of the mining association.

Mr. Godin: It is much more detailed than ours, but my personal opinion is that the mining tax or the mining incentives that have worked as well as these have should not be disturbed. I see no reason for disturbing them. If you look at the comparison of taxation paid by the mining industry in Australia and in the United States, you will see it is very close. And anything that would upset this would

have an adverse effect on future development in this country. As I have mentioned, Canada has been well prospected, and there are not too many outcrops left.

Senator Phillips (Rigaud): I am emphasizing the point, and again I am speaking as an individual, but I am convinced that the proposed treatment of the natural resource industries, mining and oil companies, as proposed by the White Paper is ill-advised. However, I am also realistic and one comes to the conclusion that when something is mentioned in the White Paper, it is not likely that there will be a complete retreat. Therefore, I think it would be helpful to this committee if, in addition to the criticism, there were alternatives to the methods of treatment he recommended. It will be very helpful to us.

Mr. Godin: These I understand will be included in the industry's brief. In our case, as I mentioned earlier, I do not see any point in changing them. They have been successful. And even with these incentives our effective tax is just now on a competitive basis with that of our competitors in other countries.

Senator Everett: Dealing with your table on page 5, the tax rate you arrived at in Canada of 42 per cent, is, as I understand it, after taking the depletion on a basis on which you earned the full depletion rate, is that correct?

Mr. Goodeve: That is correct. In other words, it is 33 per cent of 50 per cent plus 8 per cent.

Senator Everett: If you were not able to spend 50 per cent of your profit on exploration or if you were spending less than that, the tax rate would go up accordingly?

Mr. Goodeve: We have qualified it here. We have added note 1 to that table where we said that if the company had no amortization, the effective rate of tax increase to 57 percent.

Senator Everett: Well, comparing it to the United States, are our provincial taxes deductible in the United States?

Mr. Goodeve: By and large it is a very complicated thing involving a lot of algebra whereby each is calculated after deducting the other. In other words, the federal tax is deducted after calculating state taxes and state taxes are deducted after calculating the federal tax.

Senator Everett: Which comes first?

Mr. Goodeve: That is the question, but you can work it out algebraically.

Senator Everett: It works out at a lower rate even if the rates were the same between Canada and the United States by virtue of the deduction of one from the other.

Mr. Goodeve: Well, generally the state taxes are lower than, let us say, our Ontario or British Columbia 15 per cent.

Senator Everett: So the federal taxes are lower and the state taxes are lower. But by virtue of the deductibility of one from the other, even if they were the same, they would still be lower on an overall rate?

Mr. Goodeve: Sure, it would. But they also have a much greater depletion allowance.

Senator Everett: So there are three advantages to the American system. One is the lower rate of taxes, and another is the higher depletion allowance and the third is the deductibility from each other of federal and state taxes.

Mr. Goodeve: That is correct.

Senator Everett: And in the Australian system there are no state taxes at all?

Mr. Goodeve: Correct.

Senator Everett: So that results in Canada having 42 per cent effective, the United States 30, and Australia 36.

Mr. Goodeve: That is right.

Senator Everett: There is one provision in the White Paper—I think it is 5.29 and 5.30, in which the authors proposed to give a special write-off on machinery and buildings, which is not available under the present tax law. Is that more generous, when we are comparing rates of these three jurisdictions—is that more generous than the treatment which obtains in the United States and Australia?

Mr. Goodeve: Yes, it is.

Senator Everett: Is that significant?

Mr. Goodeve: I think you cannot take an isolated position about the consideration of capital cost allowances, because the company has the advantage of a three-year exemption. If you take away the three year exemption the depreciation allowance is greatly less than the United States depreciation allowance, which is approximately 50 per cent of the net profit, without limitation. In our case we are talking about 33 1/3 per cent profit, limited to one-third of your initial capital cost.

Senator Everett: Making the full expenditures on exploration, you say that the effective tax rate in Canada in the White Paper will be 42 per cent?

Mr. Goodeve: With the qualification that it could be up to 57 per cent.

Senator Everett: I say, making the full expenditure allowed in the White Paper, it will be 42 per cent?

Mr. Goodeve: That is correct.

Senator Everett: As against 30 per cent average in the United States?

Mr. Goodeve: Yes.

Senator Everett: But, taking the effect of section 5.29 and 5.30 into account, does that narrow the difference?

Mr. Goodeve: It does not narrow the effective rate. What it does is, if you discount your money on the present value basis, it improves the return on investment, on a discount basis.

Senator Everett: Is it sufficient, in your judgment, to make Canada competitive with the United States or Australia?

Mr. Goodeve: Very definitely not.

Senator Everett: Very definitely not?

Mr. Goodeve: That is right.

(SENATOR LAZARUS PHILLIPS IN THE CHAIR)

The Vice Chairman (Senator Phillips): Honourable senators, our chairman has been obliged to leave, and I have been asked, as vice-chairman, to carry on. I hope that will be agreeable to you.

Senator Laird: Australia has been mentioned, and I should tell you that it is my understanding of the Noranda situation that if the White Paper proposals were implemented, they would be inclined to spend exploration money in Australia, for example, rather than in Canada. What would be your attitude?

Mr. Godin: We are already doing that, and probably would increase it.

Senator Laird: Would you increase it?

Mr. Godin: Yes.

Senator Laird: And any other section of the world?

Mr. Godin: Yes. In the southwestern United States we are very active and just at the moment we are beginning to become active in all the Pacific rim countries where the geology is favourable and we can get a better tax rate.

Senator Laird: It goes without saying that you would be affected in your decisions by the tax climate of the place where you were spending your money?

Mr. Godin: That is right. We would prefer to find our money in Canada, obviously, but it is getting tougher to find and if we are going to be taxed at such a higher rate than other countries, it is going to be impossible.

The Vice Chairman: May I put this question to you, Mr. Godin. I think you were here this morning when the Shell brief was presented.

Mr. Godin: Yes.

The Vice Chairman: On the subject matter of capital gains, the position was taken that if it were introduced, that the rates should be handled, not on the basis of grossing it into ordinary revenue, but that it should be on the basis of a flat rate of 25 per cent maximum. Would you like to express an observation on that point on behalf of your company?

Mr. Godin: You are talking about capital gains tax in the hands of an individual?

The Vice-Chairman: Individual or corporation. The suggestion was made by Shell that we have a specific rate of 25 per cent maximum and that such a gain should not be assimilated to ordinary taxable income. Would your company like to express a view, through any of your spokesmen here?

Mr. Goodeve: I think that some sort of capital gains tax is a foregone conclusion, and I think we would prefer a one-half capital gains tax to a full one. I do not think there is any doubt that the smaller the capital gains tax the better we would like it. What concerns us about the capital gains tax is that it diminishes private savings in Canada; it is a transfer of funds, if you like, from the private to the public sector.

The Vice Chairman: I think we have had considerable information on that score, and I am certain honourable senators are assimilating the material.

From the point of view of your company, we are a little more concerned in eliciting your reaction as to whether if there were a capital gains tax the proposed system under the White Paper of grossing into ordinary income would be preferable to treating it by way of a separate category and introducing a maximum rate of 25 per cent.

Senator Beaubien: Like the American system.

The Vice-Chairman: Yes more or less like the American system.

Mr. Goodeve: Yes, we prefer that to integrating it.

The Vice Chairman: You prefer that to grossing it into ordinary income?

Mr. Goodeve: Yes.

The Vice Chairman: We would have liked an expression of opinion on that score, and so we thank you.

Senator Desruisseaux: What percentage of sales is exported in your company?

Mr. Godin: At the moment McIntyre itself produces only gold and copper. The gold, of course, is all sold to the United States Mint. With regard to the copper, we have just recently been ordered to set aside a certain amount for the Canadian market; otherwise our copper is sold outside of Canada. But starting in August of this year our sales will include coal, and this will amount to some $30 million a year and will throw the percentage that you are asking out.

Senator Desruisseaux: I was really asking generally as to an average, more or less, as a percentage.

Mr. Godin: Apart from the setting aside of copper for Canadian consumption, everything else would be exported.

Senator Desruisseaux: So if this White Paper was implemented, how would it affect this export?

Mr. Godin: It would not.

Mr. Goodeve: Yes, it would. It would restrict production to the extent of the cut-back in mining activity, eventually.

Senator Desruisseaux: Would that be appreciable?

Mr. Godin: I mentioned briefly here that we have enormous reserves of metallurgical coal. Whether we could sell more or not would depend on what parts of the White Paper were implemented which affect mining.

Senator Desruisseaux: Would you be able to compete?

Mr. Godin: Our main competitors are the eastern United States producers, and on depletion alone they have a considerable advantage. We have estimated it at 40 cents a ton after tax. This is quite a bit of money when you are talking about two, three, four or five million tons a year; it is extremely important.

Senator Beaubien: Mr. Godin, they have the advantage now, before the implementation of these proposals in the White Paper.

Mr. Godin: That is right.

The Vice-Chairman: Our adviser, Mr. Gilmour, draws attention to a paragraph at the end of your 1969 annual report, which I will read into the record. It is as follows:

> In other respects McIntyre's prospects are bright indeed. Severe shortages of high quality metallurgical coking coal are becoming evident in world markets and sharp price increases have already occurred. McIntyre's great reserves of this premium quality coal place the Company in a strong position to expand substantially the present sales contracts with Japanese consumers, and to supply other world markets.

If the proposals in the White Paper were implemented into legislation, would that paragraph find a place in your annual report?

Mr. Godin: I think we would have to modify it in some respects. In fact, we have qualified it by saying "in other respects".

Senator Everett: I draw your attention to paragraph 4(b), which concerns the recommended treatment of dividends paid to the shareholders of a mining company. This is a recommendation that has received wide approval from most organizations that have appeared before this committee. As to its operation, when you assume that a corporation pays a dividend to its shareholders are you suggesting that an assumption be made that a 50 per cent tax was paid on the income of the corporation regardless of what actually happened?

Mr. Goodeve: Yes.

Senator Everett: It will not matter, then, what the deduction was for presumably here you are referring to deductions for exploration or depletion, but there are other deductions that a corporation may use to reduce its tax liability.

Mr. Goodeve: What are these other deductions you are referring to?

Senator Everett: You can have a tax deferral by way of depreciation.

Mr. Goodeve: Yes.

Senator Everett: Are you suggesting that in the case of corporate income it is to be assumed that the 50 per cent tax is paid?

Mr. Goodeve: That is right, yes.

Senator Everett: So the assumption would be that all income carries a 50 per cent creditable tax?

Mr. Goodeve: Yes, and that is to avoid penalizing the individual shareholder, in the way we have tried to illustrate here in our exhibit 3. In other words, you are conferring this incentive or benefit on the company—depletion—but under the White Paper you are going to take it away from them by not allowing full tax credit.

Senator Macnaughton: On page 8 of your submission under the heading of "Conclusion" you quote from the *Financial Times* of London. Does this, in your opinion, summarize your stand as set forth, in this submission? It is a short quotation, but it is quite effective.

Mr. Goodeve: We think it sums it up better than we could have said it ourselves.

Senator Macnaughton: In that case, may I suggest that it be read *in extenso* into the record.

The Vice-Chairman: Would you like to read that quotation from the *Financial Times* of London, which is at the conclusion of your brief?

Senator Carter: Would you give me the date on which it was published?

Mr. Goodeve: I do not have it with me, but I can certainly obtain it. The quotation is:

> It is almost incredible that a country, for long held up as an example to others in its intelligent fiscal encouragement of its mining industry, should now even be considering the removal of the kind of incentives which have helped to build up that industry into not only one of the world's biggest, but also into one of the props and mainstays of the Canadian economy.

The Vice-Chairman: Thank you very much.

Senator Carter: On page 4 you refer to the impact on marginal mines. Could you give the committee some idea what that would mean in terms of jobs if the marginal mines were closed down? How many jobs would be lost in your own operation, and how many would be lost in Canada from other marginal mines? Just approximately.

Mr. J. A. Plaxton, Geologist, McIntyre Porcupine Mines Limited: It is difficult to cover the question in whole. As an example of a marginal mine, I would consider our Madeleine Mine as such. During construction 500 men were employed there, and under normal production times it will probably be in the order of 220 men fully employed. This is in an area that is seriously depressed. I do not think I could give you the figures beyond that.

Senator Carter: You do not have any idea how many mines are operating that would be classified as marginal mines.

Mr. Plaxton: No, I do not think I can answer that, senator.

Senator Molson: Did you consider whether the impact of the distinction between widely held and closely held corporations would have any effect on your own corporation? It is not mentioned in the brief, and that is why I ask.

Mr. Goodeve: It is not really relevant to McIntyre's position.

Senator Molson: You could own a closely held company. In fact, do you not own a closely held company?

Mr. Goodeve: We have two or three inactive shells.

Mr. Godin: You do not mean inactive companies?

Senator Molson: No. I mean subsidiary companies that come under that heading. You would not own any of them?

Mr. Goodeve: No.

Senator Molson: No dividend problems?

Mr. Goodeve: No. I think probably this distinction between widely held and closely held companies developed from the whole integration concept and the flow of dividends between companies to shareholders and so on. I think McIntyre's position is that it rather opposes this integration concept as a whole. We realize that probably the whole purpose behind integration is to cure some of problems relating to small family companies or large family companies as the case may be, the locked in surplus problem, the surplus stripping device and so on. But we are not sure that in solving that problem we have not created a great many more problems, particularly for the widely held company.

The Vice-Chairman: In putting this question to you, gentlemen, I am not trying to introduce an apple of discord between mining companies and oil companies. Noranda took a very emphatic position, as a responsible Canadian company, that mining companies, from the point of view of incentive legislation and entitlements in order to develop exploration and the like, required more consideration and support than did oil companies. Would you support that view of Noranda's?

Mr. Godin: I think I would to some extent.

The Vice-Chairman: To some extent?

Mr. Godin: The cases are different. We both spend money on exploration. If we are fortunate enough to find our mine our throubles are just starting. It is not quite a simple as putting in a pipeline and turning on a tap. We have all sorts of natural hazards to overcome. We are never sure what conditions underground will be when we get there. I could illustrate this with several instances. In Saskatchewan on several instances we ran into wet sand formations—hazard that had not been anticipated and was quite expensive for us. There are also hazards inherent in underground work, such as gas and explosions, faults and so on, that occur after exploration so that you cannot compare the after-exploration of the mining industry with the oil industry in that respect.

The Vice-Chairman: Mr. Godin, your company has a position in the industry as a responsible company. Do you feel that, if this committee is to deal fairly with the subject of taxation in respect of exploration and development of natural resources, it must draw a distinction between mining companies and oil and gas companies?

Mr. Godin: Yes.

Senator Burchill: Mr. Godin, how many people do you employ in your company?

Mr. Godin: At the moment we have between 1,500 and 1,600 employees.

Senator Burchill: Is that your normal rate of employment?

Mr. Godin: Yes.

Senator Carter: You have said that the metallurgical coal aspect is a special case. Have you ever made any representations to the Government concerning that?

Mr. Godin: Yes we have.

Senator Carter: What was the reaction to those representations? Did the Government accept your arguments?

Mr. Godin: No. We thought we had convinced the Department of Finance of the validity of our arguments, but apparently we had not.

The Vice-Chairman: We are down to a slow burn on that one.

Now, gentlemen, have you any other points you would like to make or have you any particular further references to your brief, or any other thoughts on the matter?

Mr. Godin: No, I don't think so, senator. As I have said, the mining industry in general is going to be very minutely covered in subsequent briefs so we sought to bring to your attention our own particular situation, and we appreciate very much having been heard.

The Vice-Chairman: On behalf of honourable senators may I express our thanks for your being here this afternoon. We have listened with interest and attention to what you have said. Thank you.

The committee adjourned.

APPENDIX "A"

Shell Canada Limited

Submission to the

Standing Senate Committee on Banking, Trade & Commerce on

Proposals for Tax Reform

Table of Contents

Summary of Submission

This Company supports tax reform, but not when it is to be implemented by sweeping structural changes, without real knowledge of their economic impact or, for that matter, of their contribution to basic equity.

Tax Reform as a Package

The White Paper presents essentially a package proposal. It seeks to establish a brand new structure which is built with logic and arithmetical balance, and which is founded in large measure on the Carter principle of identical tax treatment of all forms of annual financial accretion by individuals. But close examination of the package shows that rigid adherence to logic and balance can result in severe economic damage. It also shows that the Carter criterion of equity is deceptive and that there would be substitution of a new set of inequities for the old.

Impact on Economy

As to economic damage, we must leave to the banking and investment experts the detailed analysis of the impact on savings and investment, although we share their concern that Canada would suffer a shortage of the capital needed for continued growth.

We would only add, in this regard, that the destructive features of some basic proposals are self-evident. For example, a much harsher approach is taken to capital gains taxation than that of other young countries which need risk capital and initiative, and of our mature next-door neighbour. Moreover, the unique experiment is to be undertaken of taxing unrealized gains. Here, the obligation to raise funds to pay a premature tax has unknown economic and personal hardship implications; non-residents are faced with a penalty for having gone public in Canada, and can expect little co-operation from their own jurisdictions in avoiding double taxation.

Corporation/Shareholder Taxation

We as a company are primarily concerned with the direct and indirect impact of the proposed "creditable tax" system for integrating corporate/shareholder taxation. We see, firstly, that this system would inevitably favour investment in mature or even declining companies, while discouraging investment in growth companies: the latter typically pay low corporate taxes because of incentives like capital cost allowance, research grants and depletion allowances

Secondly, the revenue cost of crediting corporate tax back to shareholders is enormous, to say nothing of its impressive administrative expense. To this we must in large measure attribute the proposed compression of the personal rate schedule and the resultant deterioration in the tax position of the already heavily burdened middle-income group. This group comprises the trained and talented people which Canada and this Company needs to attract and retain.

Equity

As to equity, we see that short-term speculators' gains are to be taxed on the same basis as long-term investors' gains. We see that investors' gains, which have accrued over several or many years, are to be taxed as ordinary income of the year. We see that part of investors' capital is to be taxed away, since inflationary gains are also to be considered as income. We see that, under the creditable tax system, an individual could obtain some $18,000 of dividend income annually from the shares of public corporations and pay no personal tax.

Tax Reform by Overhaul

We submit that the basic objectives of tax reform could be met by appropriate overhaul of the existing system and the appending of a realistically structured capital gains tax. In this way, the probable economic and equity impact of each proposed change could be reasonably assessed in advance. Amendments could be made in certain proposals, during public debate or after implementation, with minimal effect on other proposals.

Negative Features of Proposals

Apart from the fundamental question of approach to tax reform, we must reject the many negative features of the proposals, i.e. those which seem designed to depress growth and initiative or to risk doing so. For example, although there would be little or no effect on revenue (as tabulated in the White Paper), it is proposed to reduce the level of incentives for risk-taking in the resource industries, and to further impair the tax climate of middle-income employees by taxing as income of the year their stock option benefits and retirement savings withdrawals.

With regard to the proposed and controversial withdrawal of the low-bracket rate from small incorporated businesses, we reject the assumption that there is no risk of economic repercussions. The reasonable approach would surely be to set up automatic procedures to remove the support from those corporations which do not need it, as indicated by the size of their total incomes, and from those which are not using it for growth, as indicated by their payment of dividends out of their lightly taxed earnings.

Recommendations

The recommendations which follow reflect our concept of a completely flexible structure which could be introduced with minimal risk of damaging the economy and creating new inequities, and which could be amended and adjusted with reasonable ease to correct unforeseen faults and meet changing conditions

Essentially, these recommendations involve recognition of the distinctive characteristics of personal earned income, capital gains, corporate income and dividend income, respectively, and the varying economic and equity impact of taxing each.

Chapter 2—The Individual and Family

The personal rate schedule should be structured with the primary objective of equitably taxing personal earned income, i.e. wages, salaries and business and professional income; an important adjunct should be a special averaging system for fair taxation of benefits accruing to employees over their careers, such as retirement savings and stock options.

Chapter 3—Capital Gains as Income

Capital gains should continue to be distinguished from income gains and taxed by means of special provisions, formulae and rates; the maximum rate should be 25%; only realized gains should be taxed; there should be a lifetime rollover provision in respect of gains on shares of widely-held Canadian corporations to avoid the "locking in" of investors and to encourage them to reinvest their gains.

Chapter 4—Corporations and Their Shareholders

(i) The present separate corporation tax should be retained and should not be credited or refunded to shareholders.

(ii) A separate flat-rate withholding tax, as recommended by the Special Committee to the Minister of Finance in 1961, should be imposed on dividends paid to resident individuals; the present tax-free passage of dividends between Canadian corporations should be retained.

(iii) For truly small corporations:

- (a) the proposed "partnership option" should be available, but restricted to corporations which qualify as small by reference to the size of their total income and capital employed.
- (b) the low-bracket rate should be retained, but only as a means of deferring tax, the 21%/50% tax differential to be paid by the corporation when dividends are paid out of the lightly taxed earnings; the corporate rate schedule should be such as to progressively remove the 21% rate privilege as the level of total corporate income rises.
- (c) no further tax should be imposed when dividend payments are made out of these small corporation earnings (i.e. beyond the obligation to pay the tax differential at that time), thus achieving the White Paper objective of a maximum 50% tax on small business income.

Chapter 5—Business and Property Income

The depletion allowance incentive should be structurally designed for maximum attraction of capital to undertake Canada's major resource industry risks (see Shell's specific recommendation for a composite formula, comprising a basic percentage element and an "earned" element).

Chapter 6—Taxing International Income

The present administratively simple approach to the taxation of foreign-source income should be retained, so as not to obstruct the international movement of capital and enterprise; amendments should only be concerned with removing opportunities for diversion of Canadian-source income abroad.

Chapter 2—The Individual and Family in Tax Reform

Present Law

Personal Rate Schedule

—Present rate schedule primarily designed for taxation of regularly accruing income:
- there are no capital gains to be taxed.
- numerous provisions for excluding accumulated or lumped income from ordinary income; taxed separately under special formulae.

—Compared with U.S., Canadian schedule places heavy tax burden on middle-income group.

Example

Comparison difficult because of great variety of U.S. state taxes, U.S. joint filing privilege and much higher U.S. deductions from personal income permitted. For simplicity assume:
- married employee, 2 children under 16.
- only standard deductions used.
- no state taxes and no provincial taxes over 28%.
- U.S. social security tax as income tax.

Tax paid in 1970 on salary of $15,000 (Canadian dollars) would be:

Canada	$3,414
United States	$2,462

White Paper Proposals

—Rate schedule is redesigned:
- to moderate burden on high-income group, on presumption that it is they who will have to bring most of capital gains into income.
- to reduce maximum rate to 50% for reason above and to achieve parity with corporate tax rate (owners of closely-held corporations are able to avoid rates in excess of 50%).

—Effect would be increased taxes for already heavily burdened middle-income group (which comprises trained and talented technical, middle-management and professional people whom Canada needs to attract and retain).

Example

Using same taxpayer case, Canadian tax would rise. On other hand, U.S. "1970 Tax Reform" measures will reduce taxes by removal of surtax, increases in personal exemptions and materially increased standard deduction:

Canada	$3,590
United States	$2,121

i.e., Canadian employee would pay 69% more tax than U.S. counterpart.

At that point, respective marginal rates would be:

Canada	38.4%
United States	22.0%

Shell's Recommendations

—Restructure proposed schedule to produce fair taxation of *earned* income.

—No built-in assumptions as to which taxpayers will bear main impact of capital gains taxation.

—No constraints, either of a revenue or mechanical nature, imposed by desire to integrate corporation and shareholder taxation.

—Specific objective of structure to be reduction of tax burden on earned income of middle-income group which comprises people Canada needs for economic growth.

Reasons for Shell's Recommendations

Personal Rate Schedule

—We believe primary purpose of schedule is to fairly tax **earned** income. It cannot do this:
- if distorted by certain capital gains tax objectives.
- if designed to mechanically accommodate a system of corporation/shareholder tax integration.
- if it must absorb revenue burden of producing better return for corporate shareholders.

—Impact of proposed rate schedule on productive middle-income group has been illustrated in our Example. For them there is to be grave deterioration in whole tax climate:
- stock option incentive to be effectively removed.
- retirement savings to be harshly taxed.
- capital gains to be taxed as income; U.S. experience (contrary to White Paper assumption) is that by far the largest share of capital gains accrues to this group.

—This is to happen at time United States, our chief competitor for this leadership talent, has reformed its tax system to ensure that tax burden on these people will be rapidly and substantially reduced.

—Can be little hope that such transitory features as U.S. immigration restrictions and social problems will counter-balance this extreme monetary disparity. White Paper solution to problem of attracting and keeping people, i.e., paying higher salaries, cannot be taken seriously; seems to suggest a major addition to already grave inflationary pressures.

—Broader economic consequences of bias against middle-income group have been overlooked. These people acknowledged to be major contributors to personal savings pool; disproportionate tax burden on them would result in reduced capital formation in Canada. This would happen at time when average age of Canada's population is going down; half population will soon be under 25 years of age—these are spenders, not savers.

Chapter 2—The Individual and Family in Tax Reform
(continued)

Present Law	White Paper Proposals	Shell's Recommendations
Income Averaging — General		
—Income of a few occupations and certain unusual types of business income may be averaged over a block of years.	—All but farmers' and fishermen's block averaging formulae to be withdrawn. —General income averaging system to be introduced for all taxpayers. —Proposed system does not average; it widens current year's marginal rate brackets for year's "excess" income; that "excess" is prescribed as amount by which current year's income exceeds 133 ⅓% of average income of preceding 4 years. —Formula has no application where average income above $19 / $20,000 range	—General income averaging formula acceptable as modest beginning of procedure for equitable taxation of fluctuating incomes. —But it is not acceptable as a proper means of deriving fair tax on amounts which have accumulated over several or many years, e.g. capital gains.
Lump Sums Received by Employees		
—Section 36 permits exclusion from ordinary income of amounts withdrawn by employees from retirement savings plans: tax imposed on withdrawals at employee's average tax rate of preceding three years. —Section 85A permits exclusion from ordinary income of gains derived by employees through exercise of options to buy shares of employing companies; tax imposed on benefit in same way as above.	—Section 36 to be withdrawn. —Taxing formula in Section 85A to be withdrawn.	—Proposed general income averaging formula especially ineffectual in computing fair tax on amounts representing employee entitlements accrued over whole careers. —Retain sections 36 (employee retirement benefits) and 85A (stock options), or provide reasonable substitutes therefor. —Strictly avoid retroactivity in taxation of employee accumulations and contracts; for example, Section 36 in present form should apply to all future withdrawals by employees now 45 years of age or older and who have been members of their employers' plans for 10 years or more.
Example: Actual case of Shell mechanic at $9,000 income level retiring in 1970 and withdrawing $27,000 from Shell's retirement savings plan: Amount withdrawn $27,000 Average tax rate of last 3 years 17.54% Tax payable $ 4,735	**Example:** Same employee case, retirement in 1974; amount of $27,000 taxed as ordinary income of year, but with rate brackets widened by use of proposed "averaging" formula, to produce effective tax rate of 37.87%: $27,000 37.87% $10,224	

Reasons for Shell's Recommendations

Income Averaging — General

—Proposed formula has been purposely constructed to spare government revenues—apparently $50 million per annum is all that can be devoted to this purpose. For this reason:
- it cannot purport to be true averaging, in "block averaging" sense of spreading, say, 5 years' income evenly over period.
- only portion of current year's income bulge is taken into consideration, and even this amount receives only modest relief.
- formula not applicable to period of declining income.
- since maximum marginal rate is to be reached at $24,000 taxable income (i.e. income $26 / $27,000), and only income in excess of 133⅓% of 4-year average is dealt with by the formula, latter is useless for taxpayer whose average income is over $19 / $20,000.

—It is therefore quite misleading to suggest, as White Paper does in several places, that proposed system would substantially mitigate or justify tax impact of other important proposals. System is only modest step towards full-fledged procedure for smoothing out ordinary income bulges. It certainly cannot be pressed into service where proper averaging is vital to equity and economic reasonableness, e.g. capital gains and employee retirement savings.

Lump Sums Received by Employees

—Withdrawal of special averaging formula in Section 36 would impose harsh and unfair tax burden on employees—our Example shows tax more than doubled on retirement savings of an hourly-paid worker.

—Persons evaluating economic opportunities as between Canada and United States must also consider this negative Canadian attitude towards employee lump sum savings—U.S. "1970 Tax Reform" recognizes need for special consideration of these: their system provides combination of long-term capital gains treatment and a new, adequate averaging device.

—Particularly intolerable is **retroactivity** of such major proportions, especially for employees who are beyond age when they can alter their financial planning for retirement.

Chapter 3—Capital Gains as Income

Present Law	White Paper Proposals	Shell's Recommendations
General Structure		
—Gains and losses on **income** account are legally distinguished from those on **capital** account, and latter not included in computing income for tax purposes except through specific statutory provisions.	—Capital gains and losses to be included in computing income for tax purposes (with exception of those on sale of widely-held Canadian shares, where one-half to be included).	—Establish separate capital gains tax system.
		—Simplest and most economically tolerable structure would be inclusion of one-half of gain or loss in income; maximum tax 25% of gain.
	—Non-residents generally to be taxed in same manner, in respect of Canadian assets, but no tax on sale of widely-held Canadian shares out of a less than 25% interest.	
	—Speculative gains not distinguished from investors' gains (one-half of gains on widely-held Canadian shares into income).	—Tax speculative gains (probably defined by reference to holding period) as ordinary income.
		—Impose appropriate restrictions on loss deductions.
	Unrealized Gains	
	—Included in income on deemed realization, i.e. when gift is made or Canadian residence is abandoned.	—Do not tax unrealized gains under any circumstances.
	—Unrealized gains and losses on widely-held Canadian shares to be included in income every 5 years through compulsory revaluation.	
	—Non-residents will presumably be required to revalue as above where they hold a 25% or greater interest.	
	Rollovers	
	—Permitted only on sale of home (limited circumstances), forced realization, and in situations where there is no underlying change of ownership.	—Provide lifetime rollover in respect of investments in shares of widely-held Canadian corporations.
		—Tax rolled-over gains (i.e. accumulated *realized* gains) on death.
		—Allow executor option to revalue entire portfolio on death (voluntary deemed disposition) to determine net accrued gain.

Reasons for Shell's Recommendations

General Structure

—Capital gains should not be taxed as ordinary income because:
- they typically accrue over several or many years; there is no equity in taxing them at marginal rates of year of realization.
- they often or usually include an inflation element; to tax this is to tax investors' capital.
- Canada cannot safely impose a harsher tax than other young countries competing for capital and initiative, nor than our chief and closest competitor, the United States.

—A separate and special method is required for appropriate averaging and allowance for inflation, and to maintain incentive for risk capital investment. Simplest method appears to be to take part of gains and losses into income and set maximum rate.

—None of above considerations apply to speculative gains; there is no reason for special treatment, except to restrict deductibility of losses, i.e. Government revenue participation in unsuccessful speculation.

Unrealized Gains

—These should never be taxed because:
- there is no automatic source of funds to pay the tax.
- there is no sure and equitable way of measuring gain as of a particular day, particularly listed shares (high and low points on market).
- gain is artificial and may turn into realized loss, at which time taxpayer's marginal rate may be lower; non-resident will face double taxation, i.e., when his own jurisdiction taxes realized gain.
- 5-year revaluation applies only to widely-held shares—this will penalize non-resident owners for having permitted Canadian public participation and inhibit such action in future.

Rollovers

—We agree that investors in widely-held shares should not be locked in to particular stocks.
But periodic taxation of unrealized gains is no solution.
A lifetime rollover would serve dual purpose:
- permit uninhibited portfolio changes.
- encourage reinvestment of gains.

—There is no reason why such rolled-over **realized** gains should not be taxed on death; however, in case all such gains should have effectively disappeared through loss of portfolio value, it would seem fair to permit executor to revalue entire portfolio as at day of death and reduce or eliminate rolled-over gains.

Chapter 4 — Corporations and Their Shareholders

Present Law

General Structure

—Dividends included in ordinary income of individuals, but 20% of dividends of taxable Canadian corporations allowed as credit against total tax liability (credit cannot exceed that total — no net refund).

—Dividends passing between taxable Canadian corporations generally exempt.

—15% withholding tax on dividends to non-residents.

Example

Taxpayer married with 2 children — receives dividends from shares purchased on stock market.

Earned Income	Dividends	Total Income	Total Tax
$ 7,000	$ 100	$ 7,100	$ 891
7,000	500	7,500	924
7,000	2,000	9,000	1,098
7,000	5,000	12,000	1,534
12,000	—	12,000	2,534
—	12,000	12,000	134
—	18,276	18,276	1,319

White Paper Proposals

—Corporate taxes to be credited back to shareholders — 50% of taxes paid in case of widely-held corporations and 100% in case of closely-held; must be done within 2½ years from end of corporation's taxation year.

—Individual shareholder takes into income his dividend receipt plus his creditable tax, then applies creditable tax to reduce his total tax liability

—Provided corporations have sufficient creditable tax, shareholders of widely-held receive credit of 50% of their dividends and those of closely-held 100% (credits unconditional, i.e. can produce net refund)

—Same procedure for intercorporate dividends, except where widely-held corporation receives dividend from another widely-held; here payee corporation applies special rate of 33⅓% to grossed-up dividend.

—Procedure applies only to corporations incorporated in Canada and to resident shareholders.

Example

Earned Income	Dividends	Total Income	Total Tax
$ 7,000	$ 100	$ 7,100	$ 875
7,000	500	7,500	851
7,000	2,000	9,000	830
7,000	5,000	12,000	956
12,000	—	12,000	2,534
—	12,000	12,000	(1,142) Refund
—	18,276	18,276	NIL

Shell's Recommendations

—Retain present separate non-creditable, non-refundable corporate tax.

—Impose separate flat-rate withholding tax (probably 15%) as recommended by the Special Committee to Minister of Finance in 1961, on dividends paid to resident individuals.

—Provide option to include dividend in individual's ordinary income and claim tax withheld as credit against total tax liability.

—Retain present tax exemption of dividends passing between taxable Canadian corporations.

Example

Earned Income	Dividends	Total Income	Total Tax
$7,000	$ 100	$7,100	$898
7,000	500	7,500	958
7,000	2,000	9,000	1,183
7,000	5,000	12,000	1 633
12 000	—	12,000	2,534
—	12,000	12,000	1,800
—	18,276	18,276	2,741

(Note: White Paper exemptions and rate schedule used for proper comparison.)

Reasons for Shell's Recommendations

General Structure

—For widely-held corporations and **large** closely-held corporations, there seems to be no valid reason for crediting or refunding any part of corporate tax paid:
- no one has established that double taxation per se exists or is presently imposing an unfair burden on dividends vis-a-vis other forms of personal income; on the contrary, dividends are very lightly taxed.
- White Paper proposes relief of this hypothetical burden at enormous revenue and administrative cost.

—Proposed "creditable tax" system is non-neutral and economically damaging because:
- it benefits investors in shares of mature, slow-growth companies, while penalizing investors in growth-oriented corporations which characteristically have little or no creditable tax because of incentives like research grants, capital cost allowance, depletion allowance, etc.
- foreign investors, who are not to receive tax credits, will have incentive to purchase shares of Canadian growth companies, prices of which will be generally depressed; such action will compound Canada's major problems of foreign ownership.
- above effects will be more pronounced in case of resource industry shares because of proposed total withdrawal of dividend depletion allowances.
- proposed intercorporate dividend tax would require parent corporation to pay tax on dividends received from growth subsidiary whose taxes have been reduced by various incentives (incentives would be taxed away again, as in case of individuals receiving growth company dividends).
- there is great array of administrative problems on which the White Paper offers but superficial guidance, if any:
    - how can various classes of shareholders equitably share available creditable tax?
    - can stock dividends always be used to counter 2½ year expiry of creditable tax without injury to any shareholders?
    - will denial of credits to non-residents create treaty negotiation difficulties?

Basic equity:

—Fundamental reason for this dangerous experiment is achievement of equity for shareholders. Summaries on left are only a sample of many combinations of individual circumstances, all of which demonstrate dubious equity or outright inequity when dividends are viewed as a source of personal income and their tax treatment compared with that of earned income. We submit that a **proportional** tax on dividends would achieve higher degree of general equity than either present or proposed systems.

Chapter 4—Corporations and Their Shareholders
(continued)

Present Law	White Paper Proposals	Shell's Recommendations
Small Corporations		
—No special provisions per se. Low-bracket rate of 21% on first $35,000 of corporate earnings available to all corporations (subject to associated corporation rules).	—No proposals specially applicable to small corporations as such. Closely-held corporations distinguished from widely-held, but former can be very large and compete with widely-held. —"Partnership option" available to closely-held corporations regardless of size (there are some restrictions, e.g. no non-resident shareholders). —Present low-bracket rate to be withdrawn from all corporations regardless of size.	—Restrict "partnership option" to closely-held corporations which qualify as small, by reference to size of income and capital employed of the corporation and those with which it is associated, if any. —Retain low-bracket rate, but only in form of deferred tax liability; difference between low-bracket and full corporate rate to be paid at time dividends are paid out of the retained earnings which were taxed at low rate. —Deem dividends paid by a corporation which has such a surplus to have been paid first out of that surplus. —Impose no further tax on dividends paid out of that surplus (thus retaining proposed maximum 50% tax on earnings of small corporations). —Subject low-bracket rate to a formula which would, on progressive basis, produce full corporate rate on *all* earnings of a corporation once they reach a certain level.

Reasons for Shell's Recommendations

Small Corporations

—We believe that truly **small** corporations (but only those) should have tax treatment equivalent to that accorded to unincorporated businesses with which they compete. This requires the partnership option, and where this is not or cannot be used, then overall tax on earnings should be limited to 50%, i.e. distributions without dividend tax.

—To ensure this treatment is granted only to small corporations (which is not synonomous with closely-held) we would restrict the partnership option on basis of size criteria. We would not wish to have a system such as White Paper proposes, which imposes lower overall tax on earnings of **large** closely-held corporations than on those of widely-held corporations with which they compete, nor to provide disincentive to their going public.

—With regard to 50% maximum tax on small corporation earnings, i.e. freedom of shareholders from dividend tax, we would accomplish this automatically by providing that this applied only to identified tax-paid surplus representing the first $35,000 of annual earnings which had qualified for low-bracket rate (see below).

—We cannot accept proposal that present low-bracket rate be simply withdrawn, since there is general agreement that some of present assistance to small business growth is valuable or even vital to economy. And we believe the often suggested alternatives either fail in horizontal equity or are administratively unwieldy.
A relatively simple solution seems to be:
- take low-bracket rate privilege away from those corporations which, as indicated by size of their total incomes, do not require government assistance.
- take it away from those small corporations which are not, as evidenced by dividend payments, using lightly taxed earnings to finance growth.
- leading to the concept that 21%/50% tax differential on the first $35,000 of earnings is a liability which is deferred until dividends are paid out of those earnings.

Present Law	White Paper Proposals	Shell's Recommendations
Operators' Depletion Allowance		
—Regulation No. 1201: 33⅓% of "net" production profits, i.e. operating profits reduced by all land acquisition costs and exploration and development expenditures applied against profits in the year.	—Percentage depletion to be completely withdrawn. —Earned allowances to be granted: ⅓ of expenditures on exploration and development (not land acquisition costs). —Annual **maximum** allowance to remain as at present, i.e. 33⅓% of "net". —Excess of allowance earned over annual maximum, eligible for carry-forward indefinitely.	—Provide composite allowance formula: – basic 10% of gross production profits *plus* – ¼ of exploration, development and Crown land acquisition costs. —Retain proposed annual maximum (33⅓% of "net") if considered necessary to protect government revenues. —Permit indefinite carry-forward of both segments of allowance if in excess of annual maximum.

Example 1: Mature producing company with no exploration program.

Present Law		White Paper Proposals		Shell's Recommendations	
Net operating profits	$6,000		$6,000		$6,000
Exploration & development	—		—		—
"Net" profits	$6,000		$6,000		$6,000
Allowance:		Allowance:		Allowance:	
				– 10% of $10,000 (assumed gross)	$1,000
				– ¼ of NIL expenditures	—
– 33⅓% of "net"	$2,000	– ⅓ of NIL expenditures	NIL		$1,000

Example 2: Growth company with heavy exploration program.

Present Law		White Paper Proposals		Shell's Recommendations	
Net operating profits	$6,000		$6,000		$6,000
Exploration & development	(4,000)		(4,000)		(4,000)
"Net" profits	$2,000		$2,000		$2,000
Allowance:		Allowance:		Allowance:	
				– 10% of $10,000 (assumed gross)	$1,000
				– ¼ of $4,000	1,000
– 33⅓% of "net"	$ 667	– ⅓ of $4,000	$1,333		$2,000
		Maximum – 33⅓% of "net"	$ 667	Maximum – 33⅓% of "net"	$ 667
Deductible in year	$ 667	Deductible in year	$ 667	Deductible in year	$ 667
Carried forward	NIL	Carried forward	$ 666	Carried forward	$1,333

Reasons for Shell's Recommendations

Operators' Depletion Allowance

—Proposed retention of present 33⅓% of "net" as an annual maximum severely weakens intended incentive: the greater the capital expenditures in the year, the lower is that year's deduction.

—Proposed incentive is grant-like and pays to get work done; there is no additional or continuing reward for success and no special compensation for undertaking the major risks, e.g. in far north and other outlying exploratory areas where huge amounts of investment capital are required to develop Canada's resource potential.

—After recovery of 133⅓% of risk capital investment, the further hoped-for production income is to be taxed at full corporate rate (as compared to U.S. effective rate of less than 35%)—this form of incentive not likely to be attractive to the international capital pools for which Canada must compete.

—Proposal founded on concept that continued devotion of one-half of profits to new exploration would maintain allowances at present level. This is surely unrealistic. If half of profits never to be realized, rate of return on new projects cannot be attractive. No one will spend money just for sake of allowances.

—It is evident, therefore, that an incentive of limited effectiveness and certain waste of revenue would result from putting every dollar of government support into the $1 for $3 spent formula. Some element of percentage depletion must remain.

—Our recommended formula results from following approach:
- 20% of gross production revenue should be target allowance (equates to White Paper annual maximum of 33⅓% of "net" where no further work is being done; U.S. rate is 22% of gross).
- break total allowance into two equal parts, i.e. a **basic** 10% of gross production, requiring additional 10% to be earned.
- set reasonably high work requirement: with formula of $1 of allowance for every $4 spent on exploration, development and Crown land acquisition costs: producers could only obtain full extra 10% by reinvesting 66⅔% of their operating profits.
- if government revenues must be protected by retention of present 33⅓% of "net" as an annual maximum, then restriction would be more tolerable under our recommended formula.

Chapter 5—Business and Property Income (Petroleum)
(continued)

Present Law

Transitional Period Allowances

Not applicable.

White Paper Proposals

—To apply only to profits from properties held on White Paper day:
- depletion allowances computed on present 33⅓% of "net" may be claimed for 5 more years.
- any allowances earned through eligible expenditures during period may be carried forward for application against profits of sixth and subsequent years.

Example 1
(one of years of transitional period)

Net operating profits	$6,000
Exploration & development	—
"Net" profits	$6,000
*Allowance: 33⅓% of "net"	$2,000
Earned allowance carried forward	NIL

Example 2

Net operating profits	$6,000
Exploration & development	(6,000)
"Net" profits	$ —
Allowance: 33⅓% of "net"	NIL
Earned allowance carried forward	$2,000

*During 5-year period only.

Shell's Recommendations

—Provide no transitional period; Shell's recommended system (see previous page) to apply from outset to all properties, whether "old" or "new".

Example 1

	$6,000
	—
	$6,000
*Allowance: new Shell formula	$1,000
	NIL

Example 2

	$6,000
	(6,000)
	$ —
Allowance: new Shell formula	$2,500
Maximum—33⅓% of "net"	NIL
Deductible in year	NIL
Carried forward	$2,500

*For life of reserves.

Reasons for Shell's Recommendations

Transitional Period Allowances

—Percentage depletion allowances proposed to continue for 5 more years only in respect of profits earned through past investments. This way of mitigating retroactivity is highly inequitable:

- would apply whether petroleum reserves just developed or nearing exhaustion; some producers will have just finished their work and would have 85% of their allowance expectations removed (e.g. 25 years of a 30-year field life).
- some producers would receive no benefit at all from transitional arrangements; their depletion bases would be nil because still absorbing exploration and development expenses of past.
- producers now planning work would tend to maximize their depletion bases by delaying expenditures for 5 years; to extent they are unable to do this, would be penalized as above (compare Examples 1 and 2).

—Rough form of horizontal equity could be achieved by substantially lengthening transitional period. However, if Shell's recommended formula (see previous page) adopted, problem would be automatically solved by eliminating transitional period and making new system apply from outset:

- producers who plan no further work on properties would have allowances reduced to one-half of present expectations (i.e. to basic 10% of gross production revenue—see Example 1), but allowances would continue for life of resources.
- producers doing new work during next 5 years would not destroy depletion allowance entitlements thereby; basic 10% of gross allowance would apply and be carried forward, along with allowance earned on $1 for $4 basis, for application against profits of future years (see Example 2).

Chapter 5—Business and Property Income (Petroleum)
(continued)

Present Law

Non-operators' Depletion Allowance

—Regulation No. 1202:
25% of royalty-type income (i.e. where holder does not share in costs of operating resource).

Example

	Production	Royalties
Gross profits	$10,000	$1,000
Operating expenses	(4,000)	—
Exploration & development	—	—
"Net" profits	$ 6,000	$1,000
Allowance—33⅓% of "net"	$ 2,000	
Allowance—25%		$ 250

White Paper Proposals

—Complete and presumably immediate withdrawal.

Example

	Production	Royalties
	$10,000	$1,000
	(4,000)	—
	—	—
	$ 6,000	$1,000
Allowance—⅓ of NIL	NIL	
Allowance withdrawn		NIL

Shell's Recommendations

—Provide same allowance basis as for operators (except no greater deduction than 20% for non-operating income in any year).

Example

	Production	Royalties
	$10,000	$1,000
	(4 000)	—
	—	—
	$ 6,000	$1,000
Allowance—10% of gross	$ 1,000	
Allowance—10% of gross		$ 100

Illustration of Non-operators' Annual Maximum (assume large carry-forward of allowances from prior years).

	Production	Royalties
"Net" profits (as before)	$ 6,000	$1,000
Maximum—33⅓%	$ 2,000	
Maximum—20%		$ 200

Reasons for Shell's Recommendations

Non-operators' Depletion Allowance

—There is inadequate rationale in White Paper for ignoring retroactivity and denying any form of non-operators' depletion allowance. The following must be considered:

- existing interests were acquired in expectation of continuing 25% allowances; immediate removal of these would mean effective taxation of part of investors' capital.
- with regard to future negotiations between parties participating in exploration and development of properties: total elimination of non-operators' allowances would accomplish nothing but artificial shifting of impact to **operators** (and resultant disincentive), or conversion of prospective royalty holders to operators through their agreeing to participate in operating expenses (this being definition of "operator" in the Regulations).

—Viewed in this light, it is apparent that non-operators must have relief from retroactivity equivalent to that accorded operators, and permanent system of depletion allowances conforming to operators' system.

—Composite formula Shell has recommended for operators could be made applicable more or less automatically to non-operators' income. Basic 10% depletion element in formula would serve as the retroactivity relief which White Paper does not deal with. Moreover, no apparent reason to deny non-operators opportunity to earn additional allowances through eligible expenditures in same manner as operators.

—Only special provision apparently required is one which would prohibit deduction in any year, in respect of non-operating income, greater than 20% of that income (illustrated in Example). This is because annual maximum of 33⅓% of "net", as prescribed for operators, would otherwise automatically become 33⅓% of "gross" when applied to royalty income (no operating expenses) after exploration and development expenditures had ceased.

Chapter 5—Business and Property Income (General)
(continued)

Present Law	White Paper Proposals	Shell's Recommendations
Rental Building "Loophole"		
—For capital cost allowance purposes, costs of all of a taxpayer's buildings included in a single tax account, from which annual allowances and any proceeds of sale are deducted. Any negative balances which arise (i.e. from crediting in proceeds exceeding the balance of depreciated costs in account) must be included in income of year. Negative balance can be eliminated by charging in costs of new buildings purchased before end of year. —Losses which arise in taxpayer's business or one of his businesses may be used to reduce any of his other business profits, or other form of income in year.	—White Paper proposal in paragraph 5.17 will presumably apply to all taxpayers who rent out buildings—e.g. petroleum marketing company which leases service stations to operators: – each building costing $50,000 or more to be **separate** tax account (class), so that, if sold, any excess of proceeds over its depreciated cost must be taken into income at once. – losses in taxpayer's rental building business, to extent attributable to capital cost allowance, interest and property taxes, not deductible against his other income.	**—Proposed provisions in respect of rental buildings not to apply where the properties held for purpose of conducting taxpayer's business, if that business is other than dealing in the properties or operating them as a commercial landlord.**
Capital Cost Allowance System		
—Annual prescribed rates (e.g. most machinery 20%) are applied to balances in various classes of the taxpayer's depreciable property. —Done on "diminishing balance" basis—each class of property comprises aggregated costs of all items of that class acquired by taxpayer, reduced each year by allowances claimed and by proceeds of sale, if any. —Commencement of this system in 1949 marked abandonment of concept of sustained physical depreciation and of even write-off over assumed life of assets. —New rates were generally kept in line with old; e.g. machine written off in 10 years under old system (10% per annum) and about 90% written off in 10 years under new (20% diminishing balance).	—Paragraph 5.14 of White Paper states that "rates" of capital cost allowance may be too "generous". These are to be reviewed and taxpayers' views solicited.	**—The Government should state its general attitude and intentions without delay. —Exact nature of generosity alluded to should be defined and illustrated. —General manner in which system might be changed should be outlined.**

Reasons for Shell's Recommendations

Rental Building "Loophole"

—Unlimited application of proposed provisions would be intolerable since:
- no equity or neutrality in catching certain businesses which happen to use particular kind of asset that is sometimes subject of tax avoidance; oil company rents out service stations in order to market its products—other taxpayers rent out machinery, boats, etc., yet not affected by proposals.
- oil company may sustain overall loss on its service station rentals, but for sake of and inseparable from, profits from sale of products.
- proposals would in this case rest on a quite untenable taxation principle that single business be separated into **departments** and loss in one department not deductible from profits in another.

Capital Cost Allowance System

—Uncertainty as to future allowances which has now been injected is depressing to business growth and should be removed without delay. Major projects are being planned which, once undertaken, will entail continuing purchases of depreciable property over many years to come.

—Government attitude and intentions remain a mystery. It cannot be **rates** which are "generous":
- these rates write off depreciable assets over periods which were recognized as appropriate very many years ago, e.g. machinery over 10 years.
- these periods were never too short and have certainly not lengthened in recent years—rather reverse is the case, in view of more rapid obsolescence and modern demands for production efficiency.

It must be the diminishing balance system itself which is considered generous, i.e. because allowances are high in early years and low in later years. But this is intended incentive effect—it stimulates investment and reinvestment in modern equipment and facilities.

—Many believe present system is very **ungenerous** in not recognizing that inflation causes capital to be taxed away and that **replacement cost** should be used as base for capital cost allowance.

—If government intends to reduce or abandon incentive by fundamental system changes, they must say why, how and when; importance of matter does not permit vague and seemingly innocuous allusions.

Chapter 6—Taxing International Income

Present Law	White Paper Proposals	Shell's Recommendations
Foreign-Source Income		
—Dividends received by Canadian corporation from controlled foreign corporation (ownership of more than 25% of latter's voting shares) are exempt from Canadian tax—Section 28 (1) (d).	—Dividends received by Canadian corporation from controlled foreign corporation to be exempt from Canadian tax only where Canada has tax treaty with foreign jurisdiction.	**—Retain present simple and straightforward system.**
—Dividends other than above grossed-up and included in income; gross-up always in respect of tax paid **directly** by recipient to foreign jurisdiction (usually withholding tax), and that foreign tax allowed as credit against Canadian taxes.	—Where such dividends received from non-treaty countries, Canadian corporation is to be taxed on **fully** grossed-up dividend, i.e. including taxes paid by foreign corporation on earnings out of which dividend is paid, and claim tax credit for those foreign taxes	**—In particular, "passive income" not to be stigmatized; should be no thought of introducing administrative complexities of the U.S. experiment in this area.**
—No Canadian tax imposed on foreign corporate earnings before they are brought back to Canada as dividends, and no reference is ever made in gross-up or credit to underlying income of foreign corporation or taxes it has itself paid.	—Where controlled foreign corporation has "passive" income, Canadian corporation is to report same annually for **immediate** Canadian taxation (presumably foreign tax credit may be claimed).	**—Control foreign tax haven abuses by strict enforcement of law as to Canadian residence (place of central management and control).**
—Canadian resident corporations exempt from Canadian income tax if virtually all their business operations outside Canada ("foreign business corporations").	—"Foreign business corporations" to be taxed as any other Canadian corporation, i.e. world income taxed by Canada, and tax reduced by foreign taxes, if any, paid thereon.	**—Introduce special provisions only for purpose of imposing Canadian tax where *Canadian-source* income has been diverted abroad.**
(Above limited to subject of our comments).		
Canadian-Source Income of Non-residents		
—Pension income paid from Canada to pensioners living abroad exempt from Canadian tax. (Only item on which we comment).	—25% withholding tax to be imposed on pension payments to non-residents (with unspecified provisions for collecting additional tax or refunding part of tax withheld, presumably by reference to total income, dependants, etc., of recipient).	**—Relinquish taxation of pension income of non-residents entirely to countries in which the pensioners reside, as at present and as provided in Canada's existing tax treaties.**

Reasons for Shell's Recommendations

Foreign-Source Income

—Canada's present system is administratively simple. It is consistent with Canada's best economic interests in promoting free flow of trade, capital and enterprise throughout the world. Canada itself has great need of all of these.

—Canada cannot afford reputation of country which acts as international tax policeman.

—White Paper illustrates loopholes for avoiding tax by reference to Canadian bond interest flowing first to a tax haven and then back to Canada as a tax-exempt dividend. We agree that tax avoidance through diversion of Canadian-source income should be stopped. But we would introduce provisions specifically for this purpose rather than restructure whole system.

—We note in particular that:
- "tax treaty test" proposed is impractical, inequitable and non-neutral; it is known that some important nations see no advantage in completing a treaty with Canada.
- if Canada reaches out to collect tax that a foreign country has deliberately spared a resident business operation, development incentives offered by foreign country are nullified.
- this would place Canadians at competitive disadvantage with other nationals whose governments have more realistic approach to international taxation.

We submit that, generally, Canadians should be free to establish operations abroad in tax climate of their choice and to compete there on equal tax terms with domestic and other international operators.

Canadian-source Income of Non-residents

- If proposed tax imposed on pension income, there would be inequity because of a variety of effective rates, including nil rate, resulting from country-by-country treaty negotiations.
- Present revenue loss not great enough to warrant tax intervention; large-scale "loophole" opportunities obviously impossible.
- Canada would be moving away from international norm, as evidenced by existing treaties, which leave taxation of pensions to country of pensioner's residence.

We believe Canadian pensioners should be free to submit themselves to tax provisions of the countries of their retirement choice, without Canadian tax intervention.

Shell Canada Limited—Operating & Financial Data

		1969	1968
Operating	Gross Crude and Natural Gas Liquids Production (Thousands barrels per day)	72	68
	Gross Production and Sale of Natural Gas (Millions cubic feet per day)	402	373
	Sulphur Production (Long Tons per day)	2,100	2,000
	Refined Product & Chemical Sales (Thousands barrels per day)	211	200
	Number of Employees	6,700	6,700
Financial	Total Revenue	$850 million	$784 million
	Net Income	47 "	54 "
	Dividends Paid	17 "	17 "
	Capital & Exploration Expenditures	119 "	146 "
	Shareholder's Investment	676 "	646 "
	Common Shares Outstanding (Millions)	33	33
	Ownership Distribution		
	– Canadian	9%	9%
	– United States	2%	2%
	– Shell Group	88%	88%
	– Other Countries	1%	1%
	Return on Shareholders' Investment	7.3%	8.9%

Historical Source & Disposition of Funds Statement (1946 to 1969)	Shell Canada Has Obtained Its Funds From:		
	– Direct Investment by Shell Group	$603 million	
	– Its Own Operations	943 "	
	– Outside Debt Financing	203 "	$1,749 million
	and, Has Spent These Funds On:		
	– Exploration, Drilling, Refineries, Marketing, etc.	$1,412 million	
	– Working Capital	166 "	
	– Redemption of Long Term Debt	47 "	
	– Interest on Long Term Debt	28 "	
	– Interest and Dividends to Shell Group	87 "	
	– Common Share Dividends to Public Shareholders	9 "	$1,749 million

APPENDIX "B"

NAME: SHELL CANADA LIMITED

SUBJECT: Proposals for Tax Reform

Analysis of Appendix "A" by Senior Advisor

This brief is submitted by Shell Canada Limited.

The brief itself consists of:

(1) An introductory section offering comments on the impact of the proposals on the Canadian economy, and then further sections dealing with specific subjects, which are:

(2) The individual and the family.

(3) Capital gains.

(4) Corporations and their shareholders.

(5) Depletion.

(6) International income.

The introductory comments on the impact of the White Paper offers the following comments:

This Company supports tax reform, but not when it is to be implemented by sweeping structural changes, without real knowledge of their economic impact or, for that matter, of their contribution to basic equity.

Tax Reform as a Package

The White Paper presents essentially a package proposal. It seeks to establish a brand new structure which is built with logic and arithmetical balance, and which is founded in large measure on the Carter principle of identical tax treatment of all forms of annual financial accretion by individuals. But close examination of the package shows that rigid adherence to logic and balance can result in severe economic damage. It also shows that the Carter criterion of equity is deceptive and that there would be substitution of a new set of inequities for the old.

Impact on Economy

As to economic damage, we must leave to the banking and investment experts the detailed analysis of the impact on savings and investment, although we share their concern that Canada would suffer a shortage of the capital needed for continued growth.

We would only add, in this regard, that the destructive features of some basic proposals are self-evident. For example, a much harsher approach is taken to capital gains taxation than that of other young countries which need risk capital and initiative, and of our mature next-door neighbour. Moreover, the unique experiment is to be undertaken of taxing unrealized gains. Here, the obligation to raise funds to pay a premature tax has unknown economic and personal hardship implications; non-residents are faced with a penalty for having gone public in Canada, and can expect little co-operation from their own jurisdictions in avoiding double taxation.

Corporation/Shareholder Taxation

We as a company are primarily concerned with the direct and indirect impact of the proposed "creditable tax" system for integrating corporate/shareholder taxation. We see, firstly, that this system would inevitably favour investment in mature or even declining companies, while discouraging investment in growth companies: the latter typically pay low corporate taxes because of incentives like capital cost allowance, research grants and depletion allowances.

Secondly, the revenue cost of crediting corporate tax back to shareholders is enormous, to say nothing of its impressive administrative expense. To this we must in large measure attribute the proposed compression of the personal rate schedule and the resultant deterioration in the tax position of the already heavily burdened middle-income group. This group comprises the trained and talented people which Canada and this Company needs to attract and retain.

Equity

As to equity, we see that short-term speculators' gains are to be taxed on the same basis as long-term investors' gains. We see that investors' gains, which have accrued over several or many years, are to be taxed as ordinary income of the year. We see that part of investors' capital is to be taxed away, since inflationary gains are also to be considered as income. We see that, under the creditable tax system, an individual could obtain some $18,000 of dividend income annually from the shares of public corporations and pay no personal tax.

Tax Reform by Overhaul

We submit that the basic objectives of tax reform could be met by appropriate overhaul of the existing system and the appending of a realistically structured capital gains tax. In this way, the probable economic and equity impact of each proposed change could be reasonably assessed in advance. Amendments could be made in certain proposals, during public debate or after implementation, with minimal effect on other proposals.

Negative Features of Proposals

Apart from the fundamental question of approach to tax reform, we must reject the many negative features of the proposals, i.e. those which seem designed to depress growth and initiative or to risk doing so. For example, although there would be little or no effect on revenue (as tabulated in the White Paper), it is proposed to reduce the level of incentives for risk-taking in the resource industries, and to further impair the tax climate of middle-income employees by taxing as income of the year their stock option benefits and retirement savings withdrawals.

With regard to the proposed and controversial withdrawal of the low-bracket rate from small incorporated businesses, we reject the assumption that there is no risk of economic repercussions. The reasonable approach would surely be to set up automatic procedures to remove the support from those corporations which do not need it, as indicated by the size of their total incomes, and from those which are not using it for growth, as indicated by their payment of dividends out of their lightly taxed earnings.

The specific recommendations made in the brief are:

—The Individual and Family

The personal rate schedule should be structured with the primary objective of equitably taxing personal earned income, i.e. wages, salaries and business and professional income; an important adjunct should be a special averaging system for fair taxation of benefits accruing to employees over their careers, such as retirement savings and stock options.

Capital Gains as Income

Capital gains should continue to be distinguished from income gains and taxed by means of special provisions, formulae and rates; the maximum rate should be 25%; only realized gains should be taxed; there should be a lifetime rollover provision in respect of gains on shares of widely-held Canadian corporations to avoid the "locking in" of investors and to encourage them to reinvest their gains.

Corporations and Their Shareholders

(i) The present separate corporation tax should be retained and should not be credited or refunded to shareholders.

(ii) A separate flat-rate withholding tax, as recommended by the Special Committee to the Minister of Finance in 1961, should be imposed on dividends paid to resident individuals; the present tax-free passage of dividends between Canadian corporations should be retained.

(iii) For truly small corporations:

(a) the proposed "partnership option" should be available, but restricted to corporations which qualify as small by reference to the size of their total income and capital employed.

(b) the low-bracket rate should be retained, but only as a means of deferring tax, the 21%/50% tax differential to be paid by the corporation when dividends are paid out of the lightly taxed earnings; the corporate rate schedule should be such as to progressively remove the 21% rate privilege as the level of total corporate income rises.

(c) no further tax should be imposed when dividend payments are made out of these small corporation earnings (i.e. beyond the obligation to pay the tax differential at that time), thus achieving the White Paper objective of a maximum 50% tax on small business income.

—Business and Property Income

The depletion allowance incentive should be structurally designed for maximum attraction of capital to undertake Canada's major resource industry risks (see Shell's specific recommendation for a composite formula, comprising a basic percentage element and an "earned" element).

—Taxing International Income

The present administratively simple approach to the taxation of foreign-source income should be retained, so as not to obstruct the international movement of capital and enterprise; amendments should only be concerned with removing opportunities for diversion of Canadian-source income abroad.

Happily this brief indicates the present tax laws, White Paper proposals and submissions, so that the usual summary is not required.

APPENDIX "C"

S U B M I S S I O N

on behalf of

LIBERIAN IRON ORE LIMITED

to

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE.

with respect to

the Canadian Government's Proposals
for Tax Reform (the White Paper).

March 12 , 1970.

LIBERIAN IRON ORE LIMITED

PRINCIPAL SUBMISSIONS

In order to make it feasible for Liberian Iron Ore Limited (Lio) to continue in existence, the White Paper proposals should be modified or implemented so that:

(A) DIVIDENDS RECEIVED BY LIO FROM THE LIBERIAN AMERICAN-SWEDISH MINERALS COMPANY (LAMCO) WOULD BE EXEMPT FROM TAX IN THE HANDS OF LIO, EITHER BY CANADA ENTERING INTO A BILATERAL TAX TREATY WITH LIBERIA, OR BY ALLOWING DIVIDENDS FROM COMPANIES ESTABLISHED IN DEVELOPING COUNTRIES TO BE RECEIVED TAX FREE BY CANADIAN COMPANIES OR, PREFERABLY, BOTH.

(B) PASSIVE INCOME OF LAMCO SHOULD NOT BE TAXED ON A CURRENT BASIS IN THE HANDS OF CONTROLLING SHARE-HOLDERS.

(C) DIVIDENDS OF LIO TO LIBERIAN CITIZENS SHOULD BE EXEMPT FROM NON-RESIDENT TAX (presently allowed by Section 107(1) of the Income Tax Act).

(D) SALE OF LIO SHARES BY NON-RESIDENT SHAREHOLDERS HAVING A SUBSTANTIAL INTEREST SHOULD BE FREE OF CANADIAN CAPITAL GAINS TAX. IN ANY EVENT, NO TAX SHOULD BE LEVIED ON AN ARBITRARY FIVE YEAR REVALUATION BASIS.

I. BACKGROUND INFORMATION

1. LIBERIAN IRON ORE LIMITED (Lio) was incorporated under the Companies Act of Canada (now the Canada Corporations Act) by Letters Patent dated 8th September 1958 and its head office is in Charlottetown, Prince Edward Island. When Lio located in Canada originally it was contemplated that it would be used as a financing vehicle directed towards the North American market.

Lio has qualified as a foreign business corporation, as defined in Section 71 of the Income Tax Act of Canada, from 1958 through 1969 and expects to qualify as a foreign business corporation for 1970.

2. Lio's business consists of the holding of shares and other securities of The Liberian American-Swedish Minerals Company (Lamco), a company incorporated under the laws of Liberia. Lio owns 50% of the capital stock of Lamco (namely, one million Class B shares), the remaining 50% (one million Class A shares) being held by the Liberian Government, but Lio has the right to elect six of the eleven directors of Lamco.

In addition to the shares of Lamco, Lio holds a non interest bearing capital obligation of Lamco in the face amount of US.$12,856,000 and US.$11,000,000 principal amount of 6¼% Junior Subordinated Debentures due 1985 (Junior Subordinated Debentures). These Junior Subordinated Debentures were purchased by Lio in 1966 to enable Lamco to finance its share of the cost of the expansion program, referred to in paragraph 5 below, by the use of these funds and other funds which Lamco was then able to raise by the issue of senior debt securities.

3. Lamco has a three-fourths interest in a joint project with Liberia Bethlehem Iron Mines Company (Libeth), a subsidiary of Bethlehem Steel Corporation (Bethlehem), for the mining, production

and transportation of high grade iron ore in Liberia (the Joint Venture). Production of iron ore by the Joint Venture at its mine commenced in May 1963 and commercial shipments of iron ore from the Port of Buchanan, Liberia, commenced in July, 1963.

4. All physical properties of the Joint Venture are located in Liberia and consist of the following:-

(a) At Monrovia, the Joint Venture leases office space.

(b) At Nimba, the Joint Venture owns and maintains its mining facilities, a crusher, ore-handling facilities, including a 2 mile belt conveyor system, various industrial and office buildings and a residential community named Yekepa with approximately 10,000 inhabitants.

(c) At Buchanan, the Joint Venture owns and maintains ore-handling and stockpiling facilities, washing and pelletizing plants, harbor facilities, including breakwaters and loading quays, various industrial and office buildings and a residential community with approximately 700 inhabitants.

(d) Between Buchanan and Nimba, the Joint Venture owns and maintains a 167-mile single-track railroad with a radio-operated centralized traffic control system, switching yards at the two terminals and nine passing stations. Rolling stock owned and maintained by the Joint Venture includes 10 diesel electric locomotives and 420 ore cars.

The cost to the Joint Venture of the foregoing project, including the expansion program completed early in 1968 (described in paragraph 5 below), amounted to over US.$275,000,000.

5. The Joint Venture has a current production capacity of about 11,000,000 tons of high grade (about 65% iron) iron ore per year. It has recently expanded its existing facilities in Liberia to provide the capability of producing pellets of blast furnace grade and washed fines and to improve through the washing process the physical characteristics of its run-of-mine ore.

The expansion program involved the erection of a washing plant with an annual capacity of at least 10,000,000 tons, a pelletizing plant with an annual capacity of at least 2,000,000 tons and other industrial and residential buildings and facilities, the installation of additional ore-handling and stockpile facilities and the purchase of additional mining, railway and other equipment. Construction of the new facilities commenced at the end of 1965, and was completed early in 1968. Total cost of the expansion program to the Joint Venture was about $52,000,000 United States funds.

In addition, a new crusher station is under construction at an estimated cost of $5,700,000, United States funds, and should be completed during this year.

6. The authorized capital of Lio consists of five million (5,000,000) shares of which 3,955,025 shares are now outstanding, held by over 5,000 shareholders in Canada, the United States, Liberia and Sweden.

7. Lio paid its first dividend in August 1965 and has paid a quarterly dividend, payable February, May, August and November, since February 1966. These dividends each amounted to $0.25 US funds, per share and the directors have declared their intention to continue to pay quarterly dividends, although the declaration and payment of such dividends and their amount will necessarily depend on earnings, the financial condition of Lio and other relevant factors.

8. Under the original Concession Agreement between Lamco and the Government of Liberia, Lamco was granted the exclusive right to explore for, develop, mine, process, sell and export

iron ore and certain other minerals in and from designated areas of Liberia and in consideration of such grant, Lamco issued to the Liberian Government 1,000,000 of its Class A shares, thereby giving the Liberian Government a 50% interest in the profits of Lamco. Since that time, Bethlehem took a 25% interest in the concession which was subsequently transferred to Libeth, and the present mining Concession Agreement, dated 28th April, 1960, between the Liberian Government, Lamco and Bethlehem provides for the annual distributionto Lamco's shareholders (50% to the Liberian Government and 50% to Lio) of Lamco's net profits, computed as set forth in such Agreement.

The terms of an agreement dated as of 1st January, 1965, entered into between Lamco and the Government of Liberia with the consent of Lio, provide for quarterly advance dividend payments to said Government, as holder of the Class A shares, of up to $0.50 per ton of Lamco ore produced and shipped from Liberia out of the net profits of Lamco in any year as computed under the Concession Agreement but without giving effect to payments of interest on or principal of Lamco's subordinated indebtedness. Lamco's obligation to make such advance dividend payments is not cumulative from year to year. To the extent that profits are available after such payments to said Government, Lio, as the holder of the Class B shares, receives equalizing payments on a cumulative basis.

In view of the right of the Liberian Government to receive dividends from Lamco, as described above, the Concession Agreement provides that no export duties and no income or other taxes may be levied by the Liberian Government against Lamco or against any manager of Lamco or of the Joint Venture. The

Concession Agreement also provides that the Joint Venture shall not be regarded as a taxable entity for the purpose of Liberian income taxes.

On the other hand, a separate agreement between the Liberian Government and Libeth provides for an income tax of 50% of the net income, as defined in such agreement, from Libeth's 25% interest under the Concession Agreement.

In effect then, the Government of Liberia is entitled to 50% of the net profit or income of Lamco and Libeth from the Joint Venture but in the case of Libeth, these are described as income tax and in the case of Lamco as dividends or advance dividend payments.

II. PRESENT CANADIAN TAX POSITION OF LIO

As a foreign business corporation, Lio is exempt from tax on its income under Part I of the Income Tax Act of Canada, whether such income is in the form of dividends or interest on its Junior Subordinated Debentures of Lamco, which account for all or substantially all of the income of Lio.

However, Canadian non-resident tax is exigible on interest and dividends paid to non-residents, other than dividends paid to citizens of Liberia which are now exempt from non-resident tax pursuant to the provisions of Section 107 of the Income Tax Act, as amended in 1966.

The following statement shows the amounts of Canadian non-resident tax withheld at source and remitted by Lio:-

Amount of Tax in Canadian $

For Year	On 6% Promissory Notes and Other Loans	On Dividends	Total
1961	23,101.83	Nil	23,101.83
1962	23,994.24	Nil	23,994.24
1963	21,310.46	Nil	21,310.46
1964	17,358.73	Nil	17,358.73
1965	13,992.67	53,283.54	67,276.21
1966	26,005.86	353,395.80	379,401.66
1967	13,981.46	392,038.04	406,019.50
1968	13,928.20	386,850.77	400,778.97
1969	15,334.14	386,172.65	401,506.79
TOTALS:			
1961-1969	169,007.59	1,571,740.80	1,740,748.39

Dividends paid by Lio to its Canadian shareholders, whether corporations, individuals or other taxable entities, are taxable in the same manner and to the same extent as other income and individual Canadian shareholders are not entitled to the 20% dividend tax credit, as Lio is exempt from tax under Part I of the Income Tax Act of Canada.

III. CERTAIN PROPOSALS CONTAINED IN THE WHITE PAPER

1. The exemption from Canadian income tax accorded to "Foreign Business Corporations" will be withdrawn immediately with respect to "passive income" and over a period of five years with respect to business income (6.33).

2. The exemption of dividends received by a Canadian corporation from a controlled foreign corporation would continue subject to the following restrictions:-

(a) dividends must be from a country with which Canada has a tax treaty (6.15); and

(b) subpart F income rules of the United States' Internal Revenue Code would be introduced in Canada wherein "passive income" - dividends, interest, royalties and trans-shipment profits-of a controlled foreign

corporation would be deemed, in the year of receipt, to have been distributed to that corporation's controlling shareholders (6.21).

3. Dividends paid to a Canadian corporation from a controlled foreign corporation located in a non-tax treaty country would be subject to a tax credit regime whereby the Canadian corporation would be allowed a credit for foreign withholding taxes imposed on the dividend and for foreign corporate taxes imposed on profits from which the dividend was paid (6.17).

4. Non-residents will be taxed on capital gains upon sale of shares of "closely-held Canadian corporations" (6.46) and will also be taxed on the capital gains of shares of "widely-held Canadian corporations" if non-resident makes the sale out of a 25 per cent or more interest in the widely-held company (6.47).

5. Commencing January 1, 1974, the withholding tax rate on dividends paid to non-residents of Canada living in countries with which Canada has not concluded a tax treaty would be 25% (6.36).

IV. EFFECT OF PROPOSALS ON CANADIAN TAX POSITION OF LIO AND ITS SHAREHOLDERS

Lio would, within a period of five years, lose its status as a tax-exempt foreign business corporation. Further, dividends from Lamco received by Lio may not be deductible in determining Lio's taxable income as Canada does not have a tax treaty with Liberia, and there is no assurance that a treaty will be concluded and ratified by the end of 1973. Also, Liberia does not impose any tax on Lamco's income, nor is any tax withheld by Liberia on the payment of dividends by Lamco to Lio, and thus no credit would be available to Lio on account of such taxes.

Unless Lio was exempt from tax in Canada or was not subject to tax in Canada, for every dollar of income received from Lamco, Lio would be obliged to pay an income tax of $0.50, assuming no tax treaty would be signed between Canada and Liberia, and on distribution of the balance to its non-resident shareholders, a further tax would be payable of either $0.075 or $0.125 (depending on whether the withholding tax rate was 15% or 25%), making a total tax of either $0.575 or $0.625 per dollar of revenue as compared to the present total tax of $0.10.

Even if dividends are received by Lio tax free and assuming the minimum withholding rate of 15%, the present tax on dividends from Lamco routed through Lio would be increased by 50% (from 10% to 15% tax). This would probably be acceptable provided dividends to Liberian citizens were exempt from non-resident tax, as at present, and that the present holding of Junior Subordinated Debentures of Lamco could be convertea into some kind of preference share.

It should be noted that Canadian shareholders now pay tax at full rates on all dividends received by Lio without the benefit of the dividend tax credit.

Under the above circumstances, Canadian income and withholding taxes would consitute an unreasonable burden on the income of non Canadian residents from Liberian sources and the inevitable result would be a reorganization involving the winding-up of Lio and possibly the establishment of a similar vehicle in some other country. Based on current amount of dividends and interest and assuming a rate of 15% except on dividends to Liberian citizens, this would result in a loss to Canada of projected tax revenue of about $600,000 per year.

V. SUBMISSIONS OF LIO

The probable result of taxing dividends received by Lio from Lamco would not be to impose an addition tax burden on Lio and its shareholders, but rather to drive this corporation away from Canada.

Presently, Canada is receiving handsome tax and economic rewards for providing the locale for such companies as Lio, which have little or no Canadian source income. Canadian resident shareholders receive no preferential treatment under present law for distributions from Lio (being taxed at full rates without benefit of any reduction or credit) and there is no reason why they should do so in the future. For non-Canadian resident shareholders, Lio merely acts as a conduit pipe by channelling income from a project in a developing country through Canada. These shareholders are willing to pay a reasonable charge, by way of non-resident tax, for this privilege, but could easily find other jurisdictions in which to establish themselves if the rates were increased and, indeed, would not hesitate to do so, thereby negating the application of any Canadian tax. In addition, Canadians would lose the benefits of professional fees and other expenses incurred in Canada paid by Lio out of its foreign source income.

A brief commentary on each of the principal submissions contained on page 1 above is made below:-

1. DIVIDENDS RECEIVED BY LIO FROM THE LIBERIAN AMERICAN-SWEDISH MINERALS COMPANY (LAMCO) SHOULD BE EXEMPT FROM TAX IN THE HANDS OF LIO, EITHER BY CANADA ENTERING INTO A BILATERAL TAX TREATY WITH LIBERIA, OR BY ALLOWING DIVIDENDS FROM COMPANIES ESTABLISHED IN DEVELOPING COUNTRIES TO BE RECEIVED TAX FREE BY CANADIAN COMPANIES OR, PREFERABLY, BOTH.

A simple solution to this problem would be for Canada to conclude a bilateral tax treaty with Liberia before the implementation of legislation to put into law the proposal contained in paragraph 6.15 of the White Paper. However, the fact remains that Canada does not at this date have a tax treaty with Liberia nor, it is presumed, have preparations or discussions been entered into to negotiate such a treaty.

On the other hand, Liberia, in return for a major capital investment and 50% of the equity shares of Lamco, has entered into an agreement with Lamco that no export duties and no income or taxes of any kind in respect of activities connected with Lamco's project will be levied against Lamco, any manager of Lamco or of the Joint Venture. There is no doubt that Liberia is a developing country and as such requires capital investment.

Lio submits that in addition to the tax treaty criterion for the exemption of tax on foreign source dividends, Canadian corporations also be exempt from tax on dividends received from projects in developing countries. The recently established Canadian Export Development Corporation is promoting the investment of Canadian capital in developing countries and some financial assistance to investors would also be provided if this second criterion was to be added to the proposal contained in paragraph 6.15 of the White Paper. The Minister of Finance indicated that consideration was being given to this problem and that some proposal in this regard might be made later on.

The element of timing is essential in this matter. It is presumed that the legislation implementing this proposal will be introduced on or before January 1, 1971, to be effective as of that date. That date does not leave much time for the negotiation and signing of a bilateral tax treaty with Liberia and for this reason alone, it is important that favourable consideration be given to the additional criterion proposed above.

2. PASSIVE INCOME OF LAMCO SHOULD NOT BE TAXED ON A CURRENT BASIS IN THE HANDS OF CONTROLLING SHAREHOLDERS.

From time to time Lamco may have cash or other assets on hand which it invests and derives income therefrom. Such investments are made temporarily until the cash or other asset is required for Lamco's own use. Under the proposal contained in paragraph 6.21 of the White Paper, passive income earned from such temporary investment would be taxable in Lio's hands on a current basis. Provision is also made in the White Paper for the implementation of rules similar to those of the United States for the control of channelling passive income to a controlled foreign corporation. We understanding that these provisions are known as "Subpart F Income" rules and are found at Sections 951-964, inclusive, of the Internal Revenue Code of the United States, and have the effect of exempting from taxable income specified dividends, interest and capital gains resulting from temporary investments.

It is important to Lio that passive income of Lamco earned from temporary investments not be deemed to have been earned by Lio on a current basis and Lio therefore submits that among the provisions of any new legislation envisaged in paragraph 6.21 of the White Paper, similar exemptions be provided for dividends, interest and gains from and on investments as are presently so provided under the said Sections of the Internal Revenue Code.

3. DIVIDENDS OF LIO TO LIBERIAN CITIZENS SHOULD BE EXEMPT FROM NON-RESIDENT TAX (presently allowed by Section 107(1) of the Income Tax Act).

As the result of representations made to the Canadian Government in 1966, by Lio and the Liberian Government, Section 107 of the Income Tax Act was amended so as to exempt from

Canadian withholding tax dividends paid to non-resident shareholders of foreign business corporations deriving at least 90% of its income from mining, transporting and processing in a country where the non-resident individual shareholder resided, or where, if a corporate shareholder, individuals owning more than 50% of its voting share capital resided.

By proposing to do away with foreign business corporation, the White Paper will also do away with Section 107 of the Income Tax Act.

In 1966, the principal shareholders of Lio were reluctant to make any change in the corporate organization of Lio, but were nonetheless under pressure from the Liberian Government to reduce the incidence of Canadian tax on dividends of Lio paid to Liberian shareholders. Liberian shareholders then suggested that the objectives which motivated the organization of Lio (namely, to provide a holding company which would hold shares and other securities of Lamco, and would issue shares and other securities to the public) could well be achieved by having a Liberian holding company for this purpose, contending that there was no compelling reason to have Lamco's holding company located in Canada and thus attract Canadian withholding tax. For these reasons, Lio submits that income derived from Liberian sources should be free of Canadian tax when distributed to Liberian residents, and that provisions basically similar to those enunciated in the present Section 107 of the Income Tax Act be maintained when legislation is prepared to implement the proposals contained in paragraph 6.34 and following of the White Paper.

4. SALE OF LIO SHARES BY NON-RESIDENT SHAREHOLDERS HAVING A SUBSTANTIAL INTEREST SHOULD BE FREE OF CANADIAN CAPITAL GAINS TAX. IN ANY EVENT, NO TAX SHOULD BE LEVIED ON AN ARBITRARY FIVE YEAR REVALUATION BASIS.

The vast majority of Lio's shareholders are non-residents of Canada. Indeed, a Swedish company is the majority shareholder of Lio, and as such is exempt at present from any gain in Canada from the sale, transfer or exchange of capital assets by virtue of Article XIV of the Schedule to the 1951 Canada-Sweden Income Tax Agreement Act. Similar provisions are contained in both the Canada-United Kingdom Income Tax Agreement and in the Canada-U.S. Reciprocal Tax Convention. The exemption is indeed granted under most international tax treaties. To do otherwise, it is submitted, would be a radical departure from international usage.

In any event, no tax should be levied on an arbitrary five year revaluation basis as such revaluation and the tax exigible thereon would not be recognized in the other country and such a tax would be an additional burden for which no offset could be obtained.

THE WHOLE RESPECTFULLY SUBMITTED, THIS 12TH DAY OF MARCH, 1970.

LIBERIAN IRON ORE LIMITED

(Signed) Bertil Unne

Vice-President

(Signed) Erik Fris

Secretary-Treasurer

APPENDIX "D"

NAME: LIBERIAN IRON ORE LIMITED

SUBJECT: Taxation of Foreign Business Corporations

Analysis of Appendix "C" by Senior Advisor

This brief has been submitted by Liberian Iron Ore Limited. This is a Canadian company, incorporated in 1958, and presently exempt from annual Canadian corporation income taxes as being a Foreign Business Corporation as defined by Section 71 of the Income Tax Act.

Dividends and interest paid by the company are subject to the usual Canadian taxes.

The business of the company consists of:

(1) Holding shares and other securities of The Liberian American-Swedish Minerals Company, which latter is incorporated under the laws of Liberia.

The above holding represents 50% of the shares of the Liberian company, with the remaining 50% being held by the Liberian government; and

(2) Holding non-interest bearing capital obligations of The Liberian American-Swedish Minerals Company of a face amount of U.S. $23,856,000.

The Liberian subsidiary company has a 3/4 interest in a joint project with Liberia Bethlehem Iron Mines Company for mining, production and transportation of high grade iron ore in Liberia. Production and shipment of such ore commenced in May and July, 1963. The cost of this joint venture amounts to over U.S. $275,000,000.

The issued share capital of Liberian Iron Ore Limited consists of 3,955,025 shares held by over 5,000 shareholders in Canada, the United States, Liberia and Sweden.

At the present time the company:

(a) Is exempt from paying any annual Canadian income taxes on its income because it qualifies as a foreign business corporation, as referred to in Section 71 of the Income Tax Act.

(b) Is not required to withhold the usual 15% Canadian tax from dividends paid to shareholders who are citizens of Liberia by virtue of Section 107-1 of the Income Tax Act.

(c) Is required to withhold Canadian taxes from interest and dividends paid to non-resident creditors and other non-resident shareholders. In the period from 1961 to 1969 these Canadian taxes have totalled $1,740,748.

(d) Finally, dividends paid to Canadian shareholders are subject to the usual Canadian taxes, without benefit of the 20% Canadian dividend credit.

The brief itself comprises:

(1) A description of the company and of its operations. (Pages 2 to 6)

(2) A description of the present Canadian tax position of the company. (Pages 2 to 7)

(3) A summary of the White Paper proposals affecting the continued existence of the company. (Pages 7 to 10)

(4) Taxation of dividends received by a foreign business corporation from a non-resident operating subsidiary. (Pages 10 and 11)

(5) Passive income of a foreign business corporation. (Page 12)

(6) Canadian withholding taxes imposed on dividends paid by a foreign business corporation.

(7) The Capital Gains Tax.

Members of the Committee will observe the following forecast made in the brief:

"Under the above circumstances, Canadian income and withholding taxes would constitute an unreasonable burden on the income of non-Canadian residents from Liberian sources and the inevitable result would be a reorganization involving the winding-up of Lio and possibly the establishment of a similar vehicle in some other country. Based on current amount of dividends and interest and assuming a rate of 15% except on dividends to Liberian citizens, this would result in a loss to Canada of projected tax revenue of about $600,000 per year."

"The probable result of taxing dividends received by Lio from Lamco would not be to impose an addition tax burden on Lio and its shareholders, but rather to drive this corporation away from Canada."

The recommendations contained in the brief are:

"In order to make it feasible for Liberian Iron Ore Limited (Lio) to continue in existence, the White Paper proposals should be modified or implemented so that:

(A) Dividends received by Lio from the Liberian American-Swedish Minerals Company (Lamco) would be exempt from tax in the hands of Lio, either by Canada entering into a bilateral tax treaty with Liberia, or by allowing dividends from companies established in developing countries to be received tax free by Canadian companies, or, preferably, both.

(B) Passive income of Lamco should not be taxed on a current basis in the hands of controlling shareholders.

(C) Dividends of Lio to Liberian citizens should be exempt from non-resident tax (presently allowed by Section 107(1) of the Income Tax Act).

(D) Sale of Lio shares by non-resident shareholders having a substantial interest should be free of Canadian capital gains tax. In any event, no tax should be levied on an arbitrary five-year revaluation basis."

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: LIBERIAN IRON ORE LIMITED

Date Brief Received:

Principal Subject: Foreign Business Corporations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 71 of the Income Tax Act This section exempts from annual income taxes the income of a Canadian corporation that qualifies as a Foreign Business corporation. Section 106 and 106-a of the Income Tax Act This section requires a foreign business corporation to withhold the usual Canadian taxes from interest and dividends paid to non-residents of Canada. Section 107-1 of the Income Tax Act This section exempts from Canadian tax dividends paid to citizens of another country from which the foreign business corporation derives 90% or more of its income.	The White Paper proposals respecting foreign business corporations are: 6.31 "Foreign business corporation" is a technical expression for a type of corporation that is exempt from Canadian income tax. To qualify, a corporation must carry on all of its business operations, except management and a few other specified activities, outside Canada. Originally, this category was provided to make sure that several large Canadian public corporations with business operations entirely outside Canada did not suffer "double taxation" on their business profits. It did for these corporations what the exemption system did for corporations that operated abroad through controlled foreign corporations. 6.32 However, during the 1950s other corporations appeared that passed the test for Canadian exemption but were not taxable in any other country either, often because of Canada's tax treaties with the countries with which they traded. Canada had become a tax haven. In 1959 Parliament provided that no new foreign business corporations could be created.	Page 8, Section IV of Brief This section of the brief outlines the impact of the White Paper proposals on this company and its shareholders. It concludes that the company will be forced to withdraw from Canada.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	6.33 It is repugnant in principle to have a special status for some corporations when others which are identical in every other respect cannot qualify. Moreover, the status granted is inconsistent with the provisions proposed concerning passive foreign income of controlled foreign corporations. (Foreign business corporations could receive investment income tax-free, but controlled foreign corporations would not be permitted to do so.) The government therefore proposes to withdraw the exemption. It would be withdrawn immediately with respect to "passive income", but would be transferred to a foreign tax-credit system over a period of five years for business profits. This would give existing corporations an opportunity to rearrange their affairs. Many would likely be able to avoid double tax by qualifying their foreign operations in controlled foreign corporations. It states as a foreign business is denied, the White Paper proposes that income of such a company be subjected to the following rules:	

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	6.15 The government has concluded that neither of these systems is either "right" or "wrong". It proposes to continue in a restricted form the present exemption of dividends received by a Canadian corporation from a controlled foreign corporation. For this purpose, the Canadian corporation would be assumed to control the foreign corporation if it owns 25 per cent or more of the voting shares of the foreign corporation. The first restriction proposed is that the exemption privilege would be extended only to dividends from those countries with which we have concluded bilateral tax treaties. A second is that the effect of the exemption would be eliminated for certain types of diverted income by the proposals described below under the heading "Passive Income of Controlled Foreign Corporations." These restrictions are necessary to frustrate efforts to use the dividend exemption to reduce artificially the tax burden on tax-haven income. 6.17 A dividend from a Canadian-controlled foreign corporation not protected by tax treaty would be subject to a tax-credit regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underlying business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available	

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution. The White Paper also proposes: 6.36 Statutory withholding rates usually fall within a range of 25 to 30 per cent, although they exceed 40 per cent in the United Kingdom and some other countries. The government proposes to increase the Canadian rate to 25 per cent. This increase would, of course, not override the limitations on withholding tax rates contained in Canada's existing tax treaties. Further, Canada would generally be prepared to reduce the rate to 15 per cent in new tax treaties with other countries.	

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	6.46 This is the appropriate result provided the vendor is taxable on his capital gain on the sale of the share. He and/or the owners before him would have paid tax on the full $60,000 on the sale of their shares. Canada would have collected one tax—and only one—on the $60,000. But the vendor must be taxable, or the $60,000 would escape tax. Therefore it is proposed that non-residents as well as residents be taxed on their gains on the sale of shares of closely-held Canadian corporations. This would be buttressed by a "back-up" provision to place a responsibility on the purchaser to ensure compliance. A system of "certificates of compliance" would be necessary for private company share transfers—an awkward but necessary evil. 6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.	

Name: LIBERIAN IRON ORE LIMITED

Date Brief Received:

Principal Subject: Taxation of Dividends Received by a Foreign Business Corporation from a Non-resident Operating Subsidiary

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 71 of the Income Tax Act The present Income Tax Act exempts such income from Canadian tax.	6.15 The government has concluded that neither of these systems is either "right" or "wrong". It proposes to continue in a restricted form the present exemption of dividends received by a Canadian corporation from a controlled foreign corporation. For this purpose, the Canadian corporation would be assumed to control the foreign corporation if it owns 25 per cent or more of the voting shares of the foreign corporation. The first restriction proposed is that the exemption privilege would be extended only to dividends from those countries with which we have concluded bilateral tax treaties. A second is that the effect of the exemption would be eliminated for certain types of diverted income by the proposals described below under the heading "Passive Income of Controlled Foreign Corporations." These restrictions are necessary to frustrate efforts to use the dividend exemption to reduce artificially the tax burden on tax-haven income.	Page 10, paragraph 1 of Brief This portion of the brief suggests: (1) That dividends received by the company from Liberian American-Swedish Minerals Company be exempt from Canadian tax in the hands of the company. (2) And to accomplish this, that Canada enter into a bilateral tax treaty with Liberia, or alternatively; (3) That Canada exempt from Canadian tax all dividends received from companies in developing countries or, preferably (4) Adopt both the foregoing alternatives.

Name: LIBERIAN IRON ORE LIMITED

Date Brief Received:

Principal Subject: Passive Income of a Foreign Business Corporation

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not refer to passive income of a foreign business corporation, nor does it contain any power to tax shareholders on the income earned by a foreign subsidiary.	6.20 As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely. 6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.	Page 12, paragraph 2 of Brief This portion of the brief suggests that passive income (income derived from portfolio investments) of the company should not be taxed currently in the hands of controlling shareholders.

Name: LIBERIAN IRON ORE LIMITED

Date Brief Received:

Principal Subject: Canadian Withholding Taxes imposed on Dividends paid by a Foreign Business Corporation

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 107-1 of the Income Tax Act This section exempts from the 15% Canadian tax all dividends paid by a foreign business corporation, provided 90% of the annual income of such corporation is derived from mining, transporting and processing of ore, or from the operation of a public utility, in a country in which (1) the non-resident shareholder, if an individual, resides, or (2) if the non-resident shareholder is a corporation, individuals who own more than 50% of its share capital reside.	6.33 It is repugnant in principle to have a special status for some corporations when others which are identical in every other respect cannot qualify. Moreover, the status granted is inconsistent with the provisions proposed concerning passive foreign income of controlled foreign corporations. (Foreign business corporations could receive investment income tax-free, but controlled foreign corporations would not be permitted to do so.) The government therefore proposes to withdraw the exemption. It would be withdrawn immediately with respect to "passive income", but would be transferred to a foreign tax-credit system over a period of five years for business profits. This would give existing corporations an opportunity to rearrange their affairs. Many would likely be able to avoid double tax by qualifying their foreign operations in controlled foreign corporations. It follows that if the status of a foreign business corporation is withdrawn, the provisions of the present Section 107-1 of the Income Tax Act will lapse.	Page 12, paragraph 3 of Brief This portion of the brief suggests that dividends of the company paid to Liberian citizens should continue to be exempt from Canadian withholding taxes.

Name: LIBERIAN IRON ORE LIMITED

Date Brief Received:

Principal Subject: The Capital Gains Tax

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act makes no reference to taxation of capital gains.	The White Paper proposals respecting capital gains were reviewed on Pages 8 to 20 of the Special Study entitled, "Discussion of Principal Points of White Paper - Part 2", submitted on February 11, 1970.	Page 14, paragraph 4 of Brief This portion of the brief suggests (a) that sale of shares of the company by non-resident shareholders who have a substantial interest therein should be free of Canadian capital gain taxes, and (b) in any event, no tax should be levied on an arbitrary five-year revaluation basis.

APPENDIX "E"

SUBMISSION

of

McINTYRE PORCUPINE MINES LIMITED

RE

THE GOVERNMENT WHITE PAPER ON TAX REFORM

CONTENTS

1. INTRODUCTION AND SUMMARY

McIntyre Porcupine Mines Limited is pleased to have this opportunity of presenting its views on the Government's tax reform proposals.

McIntyre operates a copper-gold mine in the Porcupine area of Ontario which has been in continuous production since 1912, and is currently developing the Smoky River coal deposits in Northwestern Alberta which will be brought into production this year at a cost of some $47 million. In addition, the Company has a substantial investment portfolio, which includes a 37.5% interest in Falconbridge Nickel Mines, and a bond and share interest in Madeleine Mines which the Company manages and brought into production last year. An active exploration program is carried on in Canada and throughout the world.

The Government's tax reform aims are stated in the White Paper to be: equity, economic neutrality, public understanding and compliance, and provincial government acceptance, in that order. We believe that apart from meeting revenue requirements, the main object of fiscal policy should be economic growth, and submit that the tax system is one of the most powerful weapons available to government in pursuing its economic objectives. To impose on it a condition of economic neutrality while most other economic factors remain non-neutral is both unwise and inconsistent with the economic necessities of a developing country.

We are in general agreement with the other objectives but believe that they are unlikely to be achieved by the measures proposed.

In our opinion the White Paper has singled out the mining industry for unduly harsh treatment and we recommend that the Government should reconsider the proposals relating to mining so that its tremendous contribution to the Canadian economy will not be impaired. The marked decline in the industry's capital-spending intentions beyond 1971, which has been reported by the Economic Council of Canada, may be interpreted as a reflection of the industry's apprehension regarding the continuation of the tax policies which have played a key part in promoting its growth.

In this brief we intend to confine our discussion to those proposals which affect the mining industry and McIntyre.

Our case can be summed up as follows:

(1) The proposed changes will reduce return on mining investment to levels incompatible with the risks involved or with levels obtaining in other parts of the world which compete with Canada for investment capital.

(2) The present and proposed depletion regulations discriminate against metallurgical coal.

(3) The proposed treatment of inter-company dividends is inequitable.

(4) The consequences will be harmful both for the Canadian mining industry and for Canada.

2. THE INCENTIVES TO MINING

(a) The Justification for Incentives

By increasing the rate of return that can be expected from mineral discoveries the incentives increase the reward for successful exploration activity. Because of the odds against success and the enormous costs involved, that reward must be correspondingly greater than for other forms of business activity. Unless successful exploration can pay for all unsuccessful exploration on an industry-wide basis the odds become too great and exploration activity will cease.

The incentives also give recognition to the wasting nature of mineral deposits and the fact that they are becoming increasingly difficult and expensive to find, which requires that the industry must be constantly increasing its exploration expenditures in order to stay in the same place, let alone provide for growth and expansion.

Mining must also be compensated for risks which are not faced by the oil industry with which it has been compared. These are the risks of development and production, and price unpredictability.

Firstly, mines after they have been found usually have extremely difficult development problems involving remote areas, construction difficulties, transportation, labour supply, townsite problems, cost of living, etc., in addition to the inherent occupational and natural hazards with which mining has always been associated. Our Smoky River operation is an excellent example, and there are many others.

Secondly, mineral prices are determined by international supply and demand and subject to extreme fluctuations, unlike the world price structure for oil which is based on the U.S. producer price and relatively stable.

(b) The Proposed Changes

The White Paper acknowledges that mining requires some form of compensation for the risks involved but contends that the existing three-year exemption is too costly and that the depletion allowance in its present form is inefficient. It proposes, therefore, to eliminate the former entirely, although permitting a faster write-off of capital costs, and to limit the amount of depletion allowance that may be claimed to an amount equal to one-third of a Company's eligible exploration, development and new plant costs.

(c) The Total Effect

It is our belief that these two forms of incentive should not be looked at separately; they complement one another and it is the combined effect that should be examined.

The following table readily illustrates the impact of the incentives on mines of varying economic life. In each case the mine has a five-year payout — that is a cash flow sufficient to return the initial investment in five years — which is not untypical:

MINE — CAPITAL INVESTMENT $100 million
OPERATING PROFIT $ 20 million p.a.

($000's)

Economic Life	Total Operating Profit	Present Tax Allowances: Exempt Income	Capital Cost Allowance	Depletion	Taxable Income	Tax 50%	Proposed Tax Allowances: Capital Cost Allowance	Depletion*	Taxable Income	Tax 50%	% of Present Tax
8 Years	160,000	60,000	100,000	—	—	—	100,000	20,000	40,000	20,000	—
9 Years	180,000	60,000	100,000	7,000	14,000	7,000	100,000	27,000	54,000	27,000	385%
10 Years	200,000	60,000	100,000	13,000	26,000	13,000	100,000	33,300	66,600	33,300	256%
12 Years	240,000	60,000	100,000	27,000	54,000	27,000	100,000	33,300	106,600	53,300	198%
15 Years	300,000	60,000	100,000	47,000	84,000	47,000	100,000	33,300	166,600	83,300	177%
17 Years	340,000	60,000	100,000	60,000	120,000	60,000	100,000	33,300	206,600	103,300	173%
20 Years	400,000	60,000	100,000	80,000	160,000	80,000	100,000	33,300	266,600	133,300	166%
25 Years	500,000	60,000	100,000	113,000	226,000	113,000	100,000	33,300	366,600	183,300	152%

*assumes "eligible" expenditures $100 million, depletion ⅓ thereof.

In these examples the White Paper proposals have the effect of increasing taxes anywhere from 52% to 285%, depending upon the life of the mine (and this is true whether the capital invested is $1 million, $10 million or $100 million). It is obvious that the 3-year exemption favours the short-life mine and depletion the long-life mine; in the table above it is not until the 17th year that the depletion allowance is equal in value to the exemption.

The figures make it abundantly clear why the mining industry is so disturbed by the proposals. No other Canadian taxpayer, individual or corporate, is affected to anything like this degree by the White Paper.

(d) The Impact on Marginal Mines

It is surely self-evident that a tax increase of anything like the above proportions will result in a substantial decrease in the rate of return on the capital investment required to bring a new mine into production, in many cases to less than the acceptable minimum. An orebody with a potential return of less than 10% is almost universally considered uneconomic, and many large marginal low-grade deposits being exploited today would not be viable. Surely it is better for the country to derive some taxation from these marginal mines than to get nothing. The Government may forego some tax revenues to provide the incentives but this comes back many times over in an enlarged tax base — from the direct and indirect employment created and the stimulus provided by mining's capital and operating expenditures.

It is perhaps unfortunate for our industry that both the Carter Report and the White Paper have been published during times of high metal prices which would suggest to the authors that this is a sellers' market in which tax increases can be passed on to the consumer. Anyone familiar with the history of mineral prices knows that this is illusory, witness the present situation with respect to potash.

(e) International Competitive Position

No study of mining taxation can ignore the impact of provincial mining taxes which partially offset the gain on the incentives. When these are taken into account the White Paper proposals will increase the effective rate of income tax borne by Canadian mines to substantially more than the rates obtaining in the United States and Australia:

	Canada (proposed)	United States	Australia
Basic Tax Rate	50%	48%	45%
Depletion Allowance (metal mines)	(1) 33⅓% of net income	(2) The lesser of 15% of gross income or 50% of net income	20% of net income
Provincial/State Taxes (net after Federal Tax)	8%	6%	
Effective Tax Rate	(1) 42%	30% (average)	36%

Note: (1) A Canadian company may have no "earned" depletion, in which case the effective rate of tax increases to 57%.

(2) In the United States only very profitable mines would claim depletion on the gross income basis; as a general rule the 50% rate would apply.

Mining capital is international by nature and will go where the rewards are greatest. If other factors are equal or offsetting, then mining capital will flow to those areas where the tax climate is most favourable.

It is axiomatic that the proposed reduction in incentives will make companies think twice about putting risk capital into the development of high-cost ventures in difficult regions, and in these days of international financing of the world's big new mineral deposits any such retrograde step will retard the movement of foreign capital into Canada. It is sometimes forgotten that Canada has to import about one-third of its annual capital formation, most of it from the U.S., and that it could never have experienced the growth of recent years without these inflows of foreign funds.

(f) Recommendation

Because mining is internationally-oriented we submit that in the final analysis the degree of taxation to which it is subjected must be determined by the tax policies of our international competitors. The present Canadian tax incentives have been a key factor in building our mining industry into the third largest in the world, and we recommend that they be retained in their present form.

Alternatively, any change in the tax formula must maintain the industry's over-all return on investment at its present level if the existing growth pattern is to be sustained.

We submit also that if Canada is prepared to allow credit for foreign taxes it should

recognize provincial mining taxes as a tax credit rather than as a deduction from income. Failure to do so will result in mining bearing a higher tax-burden than any other industry if the incentive changes are implemented.

3. THE SPECIAL CASE OF METALLURGICAL COAL

(a) Present Treatment

There are two distinct kinds of coal mined in Canada today, steam coal and metallurgical coal, and the market and cost factors affecting each are distinctly different. Our Income Tax Act, however, does not recognize this distinction and extends to metallurgical coal the same depletion allowance of 10¢ per ton of coal mined which applies to steam coal.

We submit that the differences are such that metallurgical coal more closely resembles, and should be accorded the same treatment as other minerals which are permitted a depletion allowance of 33⅓% of profits.

We have two basic arguments: the present treatment is discriminatory, and it places us at a competitive disadvantage with foreign coal, both in export markets and within Canada.

(b) Tax Discrimination

The rate of 10¢ per ton was established in 1928 and does not reflect increases in costs or prices since, a disadvantage which does not apply to percentage depletion. In the past, however, the value per ton of Canadian coal has been quite low, but the new large metallurgical coal deposits now being developed produce a coal of considerably higher quality, cost and sales value. McIntyre's metallurgical coal will be worth over $10 per ton at the mine compared to an average value of $2 per ton for Western Canadian steam coal. The position of metallurgical coal is similar to that of potash, salt or gypsum which are also bedded deposits. To accord it different depletion treatment is discriminatory and inequitable.

(c) International Competitive Position

The United States is our principal competitor in the market for metallurgical coal. The American coal producer receives a depletion allowance of the lesser of 10% of gross income or 50% of net income; on $10 coal this is equivalent to a depletion allowance of $1 per ton, and this is in conjunction with a lower basic tax rate. It is estimated that the United States producer enjoys an after-tax advantage over Canadian producers in the order of 40¢ per ton. Western Canadian coal is not presently competitive in the large Ontario market which is now supplied by United States mines but the gap is narrowing and the change to percentage depletion would be an important factor in improving our industry's competitive position. The increased incentive is also needed to raise the additional risk capital to develop new mines and achieve maximum penetration of the huge Japanese and other world markets which are available to us.

If the White Paper proposals are implemented the percentage depletion allowance cannot

hurt the Government since the total of "earned" depletion will be unchanged; only the rate of write-off is accelerated. It will in fact be hurt if it does not permit percentage depletion for then the Canadian producer will have no incentive to confine his exploration activity to Canada, which is one of the aims of the White Paper.

4. DIVIDEND PROPOSALS

(a) Effect on Mining Companies

The White Paper proposes that dividends received by one corporation from another will no longer be exempt, but the tax will be offset wholly or in part by credits for the corporation tax of the payor corporation. This of course penalizes the shareholders of those mining companies which are in a position to minimize their tax liability through the application of depletion and capital cost allowances, and this includes all mining companies, particularly during their early life. Such companies may well show substantial profits in their accounts and pay dividends therefrom, yet have no "taxable" income, no tax to pay, and consequently no tax credit to pass on to their shareholders. To the shareholder, whether individual or corporate, this not only has the effect of nullifying any benefit from the incentives, but will result in his being more heavily taxed than shareholders in other industries, surely a disincentive to invest in mining. The effect on the ability of the mining industry to raise capital will be extremely serious.

Furthermore, it provides a distinct bias in favour of foreign ownership. If a company's increased profit (i.e., tax saving) resulting from depletion is paid out in dividends a U.S. shareholder will pay Canadian tax at only 15% whereas a Canadian shareholder in the 50% bracket will pay tax at an effective rate of 75% (that is, 50% x 150% of the incremental amount, with no offsetting tax credit).

(b) Recommended Treatment

To overcome this inequity it is recommended that dividends should pass between Canadian corporations free of tax as at present, and that in the case of individual shareholders it should be assumed that a corporation has paid full tax, in order to avoid discrimination against the shareholders of companies having tax incentives.

McIntyre is vitally concerned with this issue, on behalf of its own shareholders, and because dividends from Falconbridge comprise the major part of its income.

5. MINING AND THE NATIONAL ECONOMY

(a) Its Growth and Importance

The wide-spread influence of the mining industry upon Canada's economy is but little known to the general public.

The dramatic growth which has taken place in the Canadian mining industry since

World War II can be considered as one of the principal driving forces in Canada's economic development. Its rate of growth has exceeded that of the economy as a whole by a very considerable margin. The mineral and mineral-based industries now account for about 12 per cent of the total annual capital investment made in Canada, and for about one-quarter of the value of industrial output. Canada now ranks as the world's third largest mineral producer following the United States and the Soviet Union. It is the world's largest exporter of minerals which, in crude and fabricated form, account for almost one-third of its merchandise exports and are its largest earner of foreign exchange.

(b) Its Efficiency

At the same time mining has become Canada's most efficient industry by a wide margin, and today it is the only major industry whose productivity is equal to or better than that of its U.S. counterpart. (Our national average is only 75% of the U.S. figure.) Canada is also a world leader in the development and adoption of new mining techniques and mineral treatment processes which have played an important part in maintaining our industry's competitive position at a high level.

(c) Its Contribution to Regional Development

It is probably in the area of regional development that mining has made its greatest contribution. Mineral discoveries have been made in almost every section of Canada, providing jobs in regions of slow growth and chronic unemployment, and opening up new areas where there would otherwise be little or no economic activity. Our own operations are a case in point, benefitting as they do Northern Ontario and the depressed Gaspe area, and opening up the hinterland of Northwestern Alberta. To accomplish the same results the Federal Government is prepared to pay cash grants of up to $12 million to industrial companies to establish plants in such areas. The mining industry is not eligible for the grants nor is it protected by tariffs, moreover the tax incentives extended to mining reward only the successful operator.

6. CONCLUSION

We should like to conclude by quoting from the Financial Times of London —

> "It is almost incredible that a country, for long held up as an example to others in its intelligent fiscal encouragement of its mining industry, should now even be considering the removal of the kind of incentives which have helped to build up that industry into not only one of the world's biggest, but also into one of the props and mainstays of the Canadian economy."

McINTYRE PORCUPINE MINES LIMITED

EXHIBIT I

10-Year History 1960 - 1969

	($000's)	
Total Income	$ 73,261	100%
less Investment Income	56,955	78%
Operating Income	16,306	22%
less Exploration	8,991	
Apparent Taxable Income	7,315	
Income Taxes (Current and Deferred)	2,404	
Provincial Mining Tax	946	
Total Income and Mining Taxes	3,350	
Effective Tax Rate	46%	

EXHIBIT II

Effect of Proposed Tax on Unrealized Gains 1960 - 1969

	($000's)
McIntyre Investment in Falconbridge	$100,000
Current Market Value	312,000
Unrealized Capital Gain	$212,000
Tax thereon at 33 1/3%	$ 71,000

(note - total earnings reported by McIntyre over
10-year period $60,295,000)

EXHIBIT III

Effect of Depletion Allowance on Dividends

		A (no Depletion)	B ($20 Depletion)	Incremental Dividend
	Pre-tax earnings	$ 200	$ 200	--
	less Corporate Tax	100	90	(10)
	Cash Dividend	100	110	10
	Creditable Tax (1/2)	50	45	(5)
	Grossed-up Dividend	150	155	5
A.	Individual Tax at 50%	75	77.50	2.50
	less Tax Credit	50	45	(5)
	Net Tax	25	32.50	7.50
	Effective Tax			75%
B.	Individual Tax at 30%	45	46.50	1.50
	less Tax Credit	50	45	(5)
	Net Tax	(5)	1.50	6.50
	Effective Tax			65%

Note: non-resident pays only 15% Canadian tax on incremental amount for which he probably obtains foreign tax credit in own country.

APPENDIX "F"

NAME: McINTYRE PORCUPINE MINES LIMITED

SUBJECT: Certain of the White Paper Proposals

Analysis of Appendix "E" by Senior Advisor

This brief is submitted by McIntyre Porcupine Mines Limited.

The company operates a copper-gold mine in the Porcupine area of Ontario which has been in continuous production since 1912, and is currently developing the Smoky River coal deposits in Northwestern Alberta which will be brought into production this year at a cost of some $47 million. In addition, the Company has a substantial investment portfolio, which includes a 37.5% interest in Falconbridge Nickel Mines, and a bond and share interest in Madeleine Mines which the Company manages and brought into production last year. An active exploration program is carried on in Canada and throughout the world.

The brief itself consists of:

(1) A general statement of the impact of the White Paper proposals on the mining industry, and specific comments relating to:

(2) Comments on mining and the national economy.

(3) Mining incentives.

(4) Provincial Mining taxes.

(5) Depletion - Metallurgical coal.

(6) Grossing-up of Canadian dividends.

The comments relating to the impact of the White Paper proposals on the mining industry are:

"The government's tax reform aims are stated in the White Paper to be: equity, economic neutrality, public understanding and compliance, and provincial government acceptance, in that order. We believe that apart from meeting revenue requirements, the main object of fiscal policy should be economic growth, and submit that the tax system is one of the most powerful weapons available to government in pursuing its economic objectives. To impose on it a condition of economic neutrality while most other economic factors remain non-neutral is both unwise and inconsistent with the economic necessities of a developing country.

"We are in general agreement with the other objectives but believe that they are unlikely to be achieved by the measures proposed.

In our opinion the White Paper has singled out the mining industry for unduly harsh treatment and we recommend that the government should reconsider the proposals relating to mining so that its tremendous contribution to the Canadian oconomy will not be impaired. The marked decline in the industry's capital-spending intentions beyond 1971, which has been reported by the Economic Council of Canada, may be interpreted as a reflection of the industry's apprehension regarding the continuation of the tax policies which have played a key part in promoting its growth."

The comments on the mining industry and the national economy are:

"The wide-spread influence of the mining industry upon Canada's economy is but little known to the general public.

"The dramatic growth which has taken place in the Canadian mining industry since World War II can be considered as one of the principal driving forces in Canada's economic development. Its rate of growth has exceeded that of the economy as a whole by a very considerable margin. The mineral and mineral-based industries now account for about 12 per cent of the total annual capital investment made in Canada, and for about one-quarter of the value of industrial output. Canada now ranks as the world's third largest mineral producer following the United States and the Soviet Union. It is the world's largest exporter of minerals which, in crude and fabricated form, account for almost one-third of its merchandise exports and are its largest earner of foreign exchange.

"At the same time mining has become Canada's most efficient industry by a wide margin, and today it is the only major industry whose productivity is equal to or better than that of its U. S. counterpart. (Our national average is only 75% of the U.S. figure.) Canada is also a world leader in the development and adoption of new mining techniques and mineral treatment processes which have played an important part in maintaining our industry's competitive position at a high level.

"It is probably in the area of regional development that mining has made its greatest contribution. Mineral discoveries have been made in almost every section of Canada, providing jobs in regions of slow growth and chronic unemployment, and opening up new areas where there would otherwise be little or no economic activity. Our own operations are a case in point, benefitting as they do Northern Ontario and the depressed Gaspé area, and opening up the hinterland of Northwestern Alberta.

To accomplish the same results the federal government is prepared to pay cash grants of up to $12 million to industrial companies to establish plants in such areas. The mining industry is not eligible for the grants nor is it protected by tariffs, moreover the tax incentives extended to mining reward only the successful operator."

The views stated in the brief are summarized as follows:

(1) The proposed changes will reduce return on mining investment to levels incompatible with the risks involved or with levels obtaining in other parts of the world which compete with Canada for investment capital.

(2) The present and proposed depletion regulations discriminate against metallurgical coal.

(3) The proposed treatment of inter-company dividends is inequitable.

(4) The consequences will be harmful both for the Canadian mining industry and for Canada.

The brief concludes with the following comment:

"We should like to conclude by quoting from the Financial Times of London -

'It is almost incredible that a country, for long held up as an example to others in its intelligent fiscal encouragement of its mining industry, should now even be considering the removal of the kind of incentives which have helped to build up that industry into not only one of the world's biggest, but also into one of the props and mainstays of the Canadian economy.'"

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: McINTYRE PORCUPINE MINES LIMITED

Date Brief Received:

Principal Subject: Mining Incentives:
(a) Three Year Exemption
(b) Depletion

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83-5 of the Income Tax Act This section exempts from tax the income derived from a mine for a period of three years following commencement of commercial production. Part XII, Section 1201 of the Income Tax Regulations This section grants a depletion allowance of 33-1/3% of the balance of mineral profits remaining after deducting mining costs, capital cost allowances and 83A credits claimed in the year.	5.23 For many years special rules have been applied in determining the income derived from mining and from the production of oil and natural gas. These rules deal with the deduction of exploration and development expenses, the treatment of the purchase and sale of mineral rights, the exemption of the profits derived from a new mine during the first 36 months of commercial production, percentage depletion for operators, non-operators, and shareholders, and for the treatment of prospectors and grubstakers. 5.24 The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation. It is recognized that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases. Consequently, special arrangements are desirable to ensure that the costs of exploration and development may be charged for tax purposes as early as possible in order that taxes will only be applied when it is clear that a project will be profitable. Secondly, it is recognized that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining	Page 3, Paragraph 2 of Brief 2. THE INCENTIVES TO MINING (a) The Justification for Incentives By increasing the rate of return that can be expected from mineral discoveries the incentives increase the reward for successful exploration activity. Because of the odds against success and the enormous costs involved, that reward must be correspondingly greater than for other forms of business activity. Unless successful exploration can pay for all unsuccessful exploration on an industry-wide basis the odds become too great and exploration activity will cease. The incentives also give recognition to the wasting nature of mineral deposits and the fact that they are becoming increasingly difficult and expensive to find, which requires that the industry must be constantly increasing its exploration expenditures in order to stay in the same place, let alone provide for growth and expansion. Mining must also be compensated for risks which are not faced by the oil industry with which it has been compared. These are the risks of development and production, and price unpredictability. Firstly, mines after they have been found usually have extremely difficult development problems involving remote areas, construction difficulties, transportation, labour supply, townsite problems, cost of living, etc., in addition to the inherent occupational and natural hazards with which mining has always been associated. Our Smoky River operation is an excellent example, and there are many others.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law

Tax Reform Proposals

highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts. Just as scientific research and development are believed to warrant some special public support, the government feels that the exploration for and development of minerals still warrant some support in a form more directly related to this activity than has been the case with past depletion. It is believed that support on a less-generous scale should suffice for this purpose.

Exploration and Development Costs

5.25 The present rules concerning exploration and development costs accomplish the objective set out in the preceding paragraph: the costs of mineral exploration and development can be deducted for tax purposes early enough so that taxes will be applied only when it is clear that a project will be profitable. Under these rules, a corporation which has as its principal business either mining, the production of oil, or certain allied activities (refining and/or distributing petroleum or petroleum products, fabricating metals or operating pipelines), may deduct Canadian exploration and development costs as they are incurred. If these costs exceed the corporation's income, then it may deduct the balance of the costs in the first subsequent year in which it has enough income.

Principal Points of Brief

Secondly, mineral prices are determined by international supply and demand and subject to extreme fluctuations, unlike the world price structure for oil which is based on the U.S. producer price and relatively stable.

(b) The Proposed Changes

The White Paper acknowledges that mining requires some form of compensation for the risks involved but contends that the existing three-year exemption is too costly and that the depletion allowance in its present form is inefficient. It proposes, therefore, to eliminate the former entirely, although permitting a faster write-off of capital costs, and to limit the amount of depletion allowance that may be claimed to an amount equal to one-third of a Company's eligible exploration, development and new plant costs.

(c) The Total Effect

It is our belief that these two forms of incentive should not be looked at separately; they complement one another and it is the combined effect that should be examined.

The following table readily illustrates the impact of the incentives on mines of varying economic life. In each case the mine has a five-year payout — that is a cash flow sufficient to return the initial investment in five years — which is not untypical:

Name:

Date Brief Received:

Principal Subject:

Present Tax Law

Tax Reform Proposals

5.26 Other taxpayers may also deduct exploration and development costs as they are incurred, but if they do not meet the principal business test mentioned above, they may deduct them only from income from mineral properties. This rule has guaranteed that tax was not paid until these costs were recovered, but it has meant that taxpayers who were unsuccessful in their mineral projects have suffered losses that were not deductible for tax purposes. To cure this defect, it is proposed that taxpayers who fail to meet the principal business test be entitled to put their future exploration and development expenses in an asset class and to deduct annually part or all of their accumulated undeducted expenses up to a maximum of the greater of two amounts:

(1) their income from mineral properties before any deduction in respect of exploration and development expenses,

or

(2) 20 per cent of the net book value of the class.

For this purpose, income from mineral properties would include producing profits, royalties received, and the proceeds of the sale of mineral rights.

Principal Points of Brief

MINE — CAPITAL INVESTMENT $100 million

OPERATING PROFIT $ 20 million p.a.

($000's)

Economic Life	Total Operating Profit	Present Tax Allowances: Exempt Income	Capital Cost Allowance	Depletion	Taxable Income	Tax 50%	Proposed Tax Allowances: Capital Cost Allowance	Depletion*	Taxable Income	Tax 50%	% of Present Tax
8 Years	160,000	60,000	100,000	—	—	—	100,000	20,000	40,000	20,000	—
9 Years	180,000	60,000	100,000	7,000	14,000	7,000	100,000	27,000	54,000	27,000	385%
10 Years	200,000	60,000	100,000	13,000	26,000	13,000	100,000	33,300	66,600	33,300	256%
12 Years	240,000	60,000	100,000	27,000	54,000	27,000	100,000	33,300	106,600	53,300	198%
15 Years	300,000	60,000	100,000	47,000	84,000	47,000	100,000	33,300	166,600	83,300	177%
17 Years	340,000	60,000	100,000	60,000	120,000	60,000	100,000	33,300	206,600	103,300	173%
20 Years	400,000	60,000	100,000	80,000	160,000	80,000	100,000	33,300	266,600	133,300	166%
25 Years	500,000	60,000	100,000	113,000	226,000	113,000	100,000	33,300	366,600	183,300	152%

*assumes "eligible" expenditures $100 million, depletion ⅓ thereof.

In these examples the White Paper proposals have the effect of increasing taxes anywhere from 52% to 285%, depending upon the life of the mine (and this is true whether the capital invested is $1 million, $10 million or $100 million). It is obvious that the 3-year exemption favours the short-life mine and depletion the long-life mine; in the table above it is not until the 17th year that the depletion allowance is equal in value to the exemption.

The figures make it abundantly clear why the mining industry is so disturbed by the proposals. No other Canadian taxpayer, individual or corporate, is affected to anything like this degree by the White Paper.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law

Tax Reform Proposals

5.29 In addition to their exploration and development expenditures, mining corporations spend large sums of money on mining machinery and buildings before they know whether their new mine will be profitable. In order to recognize this risk, the government proposes to put depreciable assets of this type acquired for production from a particular new mine in a separate asset class and to permit the taxpayer to write them off for tax purposes just as fast as he has enough income from the new mine to absorb the charge. The assets concerned are those described in paragraphs (g) and (k) of class 10, which read as follows:

> "(g) a building acquired for the purpose of gaining or producing income from a mine (except an office building that is not situated on the mine property and a refinery)
>
> "(k) mining machinery and equipment acquired for the purpose of gaining or producing income from a mine."

5.30 This provision would not replace the existing right to deduct 30 per cent of the net book value of assets in this class: it would supplement it. If the new mine produces sufficient profit to absorb a deduction of more than 30 per cent, the taxpayer could make that deduction. If it does not, he could nevertheless deduct up to 30 per cent if he chooses, thereby either reducing other income or producing a business loss which could be offset against income in other years.

Principal Points of Brief

(d) The Impact on Marginal Mines

It is surely self-evident that a tax increase of anything like the above proportions will result in a substantial decrease in the rate of return on the capital investment required to bring a new mine into production, in many cases to less than the acceptable minimum. An orebody with a potential return of less than 10% is almost universally considered uneconomic, and many large marginal low-grade deposits being exploited today would not be viable. Surely it is better for the country to derive some taxation from these marginal mines than to get nothing. The Government may forego some tax revenues to provide the incentives but this comes back many times over in an enlarged tax base — from the direct and indirect employment created and the stimulus provided by mining's capital and operating expenditures.

It is perhaps unfortunate for our industry that both the Carter Report and the White Paper have been published during times of high metal prices which would suggest to the authors that this is a sellers' market in which tax increases can be passed on to the consumer. Anyone familiar with the history of mineral prices knows that this is illusory, witness the present situation with respect to potash.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law

Tax Reform Proposals

5.31 Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines.

5.32 At present the profits derived from the first three years of operation of a new mine are exempt from Canadian corporate tax. This provision provides an incentive to corporations to commit the large amounts of money necessary to develop a mine, and recognizes that this commitment must often be made at a time when the extent and quality of the ore body cannot clearly be ascertained. However, the government believes that in many instances the three-year exemption is too generous. Neither exploration and development costs nor depreciation need be deducted during the exempt period. As a result, many more than three years' profits are effectively exempt, and taxpayers can recover much more than their investment without becoming taxable.

Principal Points of Brief

(c) International Competitive Position

No study of mining taxation can ignore the impact of provincial mining taxes which partially offset the gain on the incentives. When these are taken into account the White Paper proposals will increase the effective rate of income tax borne by Canadian mines to substantially more than the rates obtaining in the United States and Australia:

	Canada (proposed)	United States	Australia
Basic Tax Rate	50%	48%	45%
Depletion Allowance (metal mines)	(1) 33⅓% of net income	(2) The lesser of 15% of gross income or 50% of net income	20% of net income
Provincial/State Taxes (net after Federal Tax)	8%	6%	....
Effective Tax Rate	(1) 42%	30% (average)	36%

Note: (1) A Canadian company may have no "earned" depletion, in which case the effective rate of tax increases to 57%.
(2) In the United States only very profitable mines would claim depletion on the gross income basis; as a general rule the 50% rate would apply.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is $33\frac{1}{3}$ per cent. Special rates of depletion are provided for gold and for coal. 5.38 As mentioned earlier, the government has concluded that the tax system should continue to contain in incentive of this nature. However, it believes that the present incentive is inefficient in two respects. First, depletion applies to all production profits regardless of the exploration effort of the taxpayer. It is only indirectly related to the activity it seeks to encourage. If a taxpayer stumbles on a mine, he would, under present rules, be entitled to a depletion allowance against the profits from that mine for all time to come, even if he never spends another cent exploring for minerals.	Mining capital is international by nature and will go where the rewards are greatest. If other factors are equal or offsetting, then mining capital will flow to those areas where the tax climate is most favourable. It is axiomatic that the proposed reduction in incentives will make companies think twice about putting risk capital into the development of high-cost ventures in difficult regions, and in these days of international financing of the world's big new mineral deposits any such retrograde step will retard the movement of foreign capital into Canada. It is sometimes forgotten that Canada has to import about one-third of its annual capital formation, most of it from the U.S., and that it could never have experienced the growth of recent years without these inflows of foreign funds. (f) Recommendation Because mining is internationally-oriented we submit that in the final analysis the degree of taxation to which it is subjected must be determined by the tax policies of our international competitors. The present Canadian tax incentives have been a key factor in building our mining industry into the third largest in the world, and we recommend that they be retained in their present form. Alternatively, any change in the tax formula must maintain the industry's over-all return on investment at its present level if the existing growth pattern is to be sustained.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	

Name: McINTYRE PORCUPINE MINES LIMITED

Date Brief Received:

Principal Subject: Provincial Mining Taxes

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
<u>Section 11-1-p of the Income Tax Act and Part VII of the Income Tax Regulations</u> These sections allow provincial mining taxes paid to be treated as an expense.	The White Paper makes no proposals respecting provincial mining taxes.	<u>Page 5, Paragraph 2 (f) of Brief</u> This portion of the brief states: "We submit also that if Canada is prepared to allow credit for foreign taxes it should recognize provincial mining taxes as a tax credit rather than as a deduction from income. Failure to do so will result in mining bearing a higher tax-burden than any other industry if the incentive changes are implemented."

Name: McINTYRE PORCUPINE MINES LIMITED

Date Brief Received:

Principal Subject: Metallurgical Coal - Depletion

Present Tax Law

Part XII, Section 1203 of the Income Tax Regulations

This section grants a depletion allowance of 10 cents per ton for each ton of coal mined in the year.

Tax Reform Proposals

5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

Principal Points of Brief

Page 6, Paragraph 3 of Brief

This portion of the brief makes the following statements:

(a) Present Treatment

There are two distinct kinds of coal mined in Canada today, steam coal and metallurgical coal, and the market and cost factors affecting each are distinctly different. Our Income Tax Act, however, does not recognize this distinction and extends to metallurgical coal the same depletion allowance of 10¢ per ton of coal mined which applies to steam coal.

We submit that the differences are such that metallurgical coal more closely resembles, and should be accorded the same treatment as other minerals which are permitted a depletion allowance of 33⅓% of profits.

We have two basic arguments: the present treatment is discriminatory, and it places us at a competitive disadvantage with foreign coal, both in export markets and within Canada.

(b) Tax Discrimination

The rate of 10¢ per ton was established in 1928 and does not reflect increases in costs or prices since, a disadvantage which does not apply to percentage depletion. In the past, however, the value per ton of Canadian coal has been quite low, but the new large metallurgical coal deposits now being developed produce a coal of considerably higher quality, cost and sales value. McIntyre's metallurgical coal will be worth over $10 per ton at the mine compared to an average value of $2 per ton for Western Canadian steam coal. The position of metallurgical coal is similar to that of potash, salt or gypsum which are also bedded deposits. To accord it different depletion treatment is discriminatory and inequitable.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law

Tax Reform Proposals

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

Principal Points of Brief

(c) International Competitive Position

The United States is our principal competitor in the market for metallurgical coal. The American coal producer receives a depletion allowance of the lesser of 10% of gross income or 50% of net income; on $10 coal this is equivalent to a depletion allowance of $1 per ton, and this is in conjunction with a lower basic tax rate. It is estimated that the United States producer enjoys an after-tax advantage over Canadian producers in the order of 40¢ per ton. Western Canadian coal is not presently competitive in the large Ontario market which is now supplied by United States mines but the gap is narrowing and the change to percentage depletion would be an important factor in improving our industry's competitive position. The increased incentive is also needed to raise the additional risk capital to develop new mines and achieve maximum penetration of the huge Japanese and other world markets which are available to us.

If the White Paper proposals are implemented the percentage depletion allowance cannot hurt the Government since the total of "earned" depletion will be unchanged; only the rate of write-off is accelerated. It will in fact be hurt if it does not permit percentage depletion for then the Canadian producer will have no incentive to confine his exploration activity to Canada, which is one of the aims of the White Paper.

Name: McINTYRE PORCUPINE MINES LIMITED

Date Brief Received:

Principal Subject: Grossing-Up of Canadian Dividends

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
This subject has been dealt with in Special Study No. 4 "Grossing-Up Canadian Dividends" dated March 4, 1970.	This subject has been dealt with in Special Study No. 4 "Grossing-Up Canadian Dividends" dated March 4, 1970.	Page 7, Paragraph 4 of Brief This portion of the brief states: (a) Effect on Mining Companies The White Paper proposes that dividends received by one corporation from another will no longer be exempt, but the tax will be offset wholly or in part by credits for the corporation tax of the payor corporation. This of course penalizes the shareholders of those mining companies which are in a position to minimize their tax liability through the application of depletion and capital cost allowances, and this includes all mining companies, particularly during their early life. Such companies may well show substantial profits in their accounts and pay dividends therefrom, yet have no "taxable" income, no tax to pay, and consequently no tax credit to pass on to their shareholders. To the shareholder, whether individual or corporate, this not only has the effect of nullifying any benefit from the incentives, but will result in his being more heavily taxed than shareholders in other industries, surely a disincentive to invest in mining. The effect on the ability of the mining industry to raise capital will be extremely serious. Furthermore, it provides a distinct bias in favour of foreign ownership. If a company's increased profit (i.e., tax saving) resulting from depletion is paid out in dividends a U.S. shareholder will pay Canadian tax at only 15% whereas a Canadian shareholder in the 50% bracket will pay tax at an effective rate of 75% (that is, 50% x 150% of the incremental amount, with no offsetting tax credit).

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(b) Recommended Treatment To overcome this inequity it is recommended that dividends should pass between Canadian corporations free of tax as at present, and that in the case of individual shareholders it should be assumed that a corporation has paid full tax, in order to avoid discrimination against the shareholders of companies having tax incentives. McIntyre is vitally concerned with this issue, on behalf of its own shareholders, and because dividends from Falconbridge comprise the major part of its income.

APPENDIX "G"

April 16, 1970

SUMMARY OF BRIEF SUBMITTED ON "PROPOSALS FOR TAX REFORM" TO THE STANDING COMMITTEE OF THE SENATE OF CANADA ON BANKING, TRADE AND COMMERCE BY BRITISH INSURANCE COMPANIES CARRYING ON GENERAL INSURANCE BUSINESS IN CANADA THROUGH CANADIAN BRANCHES

INTRODUCTION

This brief is submitted by 48 United Kingdom insurance companies carrying on general insurance business in Canada through their Canadian branches, and through the direction of 23 Canadian subsidiary companies. Some companies operate as single entities, whilst others under common ownership are managed as a group which may comprise solely Canadian branches or both Canadian branches and Canadian subsidiary companies. This segment of the market provides 30% of the general insurance coverage of Canadians and the premiums written in 1969 totalled some $400,000,000. Although some matters raised in this brief may be of interest to a wider section of the Canadian insurance industry we do not presume to speak for others.

PRESENT BASIS OF TAXATION

For many years Canadian branches have paid Canadian income taxes on underwriting profits earned in Canada and, although the impact of the 1969 provisions of the Canadian Income Tax Act is not as yet fully known, the income taxes presently payable have been sharply increased.

The taxes imposed by the Act exceed 60%, consisting of Canadian and provincial taxes of approximately 53.4% and a 15% tax on the balance of 46.6%. This rate compares with the United Kingdom tax of 45% imposed on the revenues of the Canadian branches. A United Kingdom company may accordingly pay Canadian income taxes of up to 15% in excess of that paid in its own country for which no relief may be obtained.

SUBMISSION.

We believe that the tax laws of a country play a vital role in attracting or discouraging overseas business enterprise and capital. In a highly competitive international market we consider it is essential that any country wishing to maintain and develop its share of overseas enterprise and capital must ensure that its tax laws attract investment by non-residents by not getting out of step with those of its competitors. Accordingly, our submissions set out the following aspects relating to the White Paper which we consider as vital factors to the British insurance companies:

(A) Dividend tax credit.

(B) Group relief for trading losses.

(C) Transfers of assets within groups of companies.

(D) Operating losses.

(A) DIVIDEND TAX CREDIT

Under the Canadian Income Tax Act, the Canadian branch of a United Kingdom company is at present taxed at the rate of 15% on dividends received from Canadian companies. However, under the White Paper Proposals such dividends would be subject to the full weight of Canadian tax, at present 60%. Further, only Canadian shareholders would be given a dividend tax credit for the tax paid by Canadian corporations. The effect of this is that, of a $100 income before tax of a Canadian Corporation set aside for dividend payment, only $21.25 of the dividend payment would be retained by a Canadian branch after payment of all Canadian taxes. In the hands of the United Kingdom company this would represent an effective Canadian rate of tax of 78.75% imposed on the income of the Canadian company, which compares with a rate of 45% for a similar investment in the United Kingdom. We submit that any legislation implementing the

White Paper should make it clear that, in the case of a British insurance company operating through a permanent establishment in Canada, the dividend tax credit should be extended to such a company, which would produce an effective tax rate under the White Paper Proposals of 57½% (i.e., 50% Canadian and provincial taxes on the income earned by the corporation paying the dividend, plus 15% tax on the balance in the hands of the recipient Canadian branch).

(B) GROUP RELIEF FOR TRADING LOSSES

The White Paper Proposals do not extend to Canadian branches of British insurance companies the right to elect to be taxed as a partnership but, as already stated, some British companies carry on their insurance business in Canada through groups comprising a number of companies under common control or ownership. In 1967, a new conception of group relief was introduced into the United Kingdom legislation whereby, within certain limits, a member of a group of companies could "inherit", for tax purposes, the losses of another member of that same group. We respectfully submit that the Canadian branches of such groups be given the same right in Canadian tax law to offset a loss in one company against the profit in another company of the same group.

(C) TRANSFER OF ASSETS WITHIN GROUPS OF COMPANIES

There has, in recent years, been an increasing number of mergers of insurance companies in the United Kingdom. It should be stated that in almost every case the business carried on by each member of the enlarged group is practically identical. For good business reasons, and this applies equally to Canada, it has not been possible to reduce the membership of the enlarged group to one single company; however, the group has looked upon the whole of its operations as

being one effective business. Rationalisation is proceeding at such a pace that in a comparatively short period of time the number of Canadian branches of British companies operating in Canada has reduced from 62 to 48 despite the fact that under existing tax legislation there could have been increased Canadian tax from so doing. This trend is expected to continue. If the tax on capital gains as proposed in the White Paper were introduced, the tax cost would become much more severe. United Kingdom legislation provides that a group of companies may transfer assets between companies comprising the group at cost without such transfer being considered to be a sale or purchase for the purposes of the tax on capital gains. We respectfully submit that Canadian branches be given the right:

(a) to effect transfers of assets within the group of Canadian branches without attracting any additional Canadian taxes;

(b) to effect transfers within the group from Canadian branches to Canadian subsidiary companies without attracting any additional Canadian taxes; and

(c) to establish the cost of investments owned by a company within the group at November 7, 1969 at the higher of original cost of the investment to the group or market value on the valuation date (i.e. preserving the benefit of any existing "tax-free run-up" within the group).

(D) OPERATING LOSSES

The present Canadian Income Tax Act provides for a tax loss in a taxation year to be applied against the profit of the immediately

preceding year and any remaining balance of loss against the operating profits of the five subsequent years. Whilst no reference is made to operating losses in the Proposals for Tax Reform, the Royal Commission on Taxation proposed that no limitation be placed on the right to apply business losses incurred in one year against operating profits earned in other years.

We would like to point out that the very essence of our insurance business is the spreading of risks so evening out losses between person and person, territory and territory and one year and another. In any one territory a company may find its results fluctuate severely from one year to another between profits and losses. Such fluctuations are potentially greater in periods embracing major catastrophes such as earthquakes and hurricanes and civil disturbances and it is essential that the companies be assured that if they should suffer a disproportionately heavy loss in any one year there will be a right for such a loss to be carried forward until extinction.

We submit that the present five year limitation has been proved in many territories to have been inadequate for an insurance company carrying on general insurance business and wish to point out that there is a trend in international taxation legislation to recognise this situation and to provide for losses to be carried forward indefinitely until fully recovered. The United Kingdom is one such country. We therefore respectfully submit that the Canadian branches and Canadian subsidiary companies of British insurance companies be permitted an indefinite period in which tax losses incurred in one year can be applied against subsequent taxable profits.

BRITISH INSURANCE COMPANIES THAT
CARRY ON THE BUSINESS OF GENERAL
INSURANCE IN CANADA THROUGH
CANADIAN BRANCHES

April 16, 1970

SUBMISSION TO THE STANDING COMMITTEE
OF THE SENATE OF CANADA ON BANKING,
TRADE AND COMMERCE WHICH IS EXAMINING
AND REPORTING ON THE WHITE PAPER
INTITULED "PROPOSALS FOR TAX REFORM"

British Insurance Companies that
Carry on the Business of General
Insurance in Canada through
Canadian Branches

Introduction

This brief is being submitted by some 24 groups comprising 48 companies incorporated under the laws of the United Kingdom that carry on a general insurance business in Canada through branches maintained in Canada, and through the direction of Canadian subsidiary companies. A list of the British companies is attached as Exhibit 1, and a list of 23 Canadian subsidiary companies appears as Exhibit 2.

All of the companies represented here, except a few whose business is restricted to Aviation and Marine Insurance, are members of the Insurance Bureau of Canada. The Bureau is submitting a brief to your Committee and to the Standing Committee of the House of Commons on Finance, Trade and Economic Affairs. No part of that brief is in conflict with the present submission.

The Canadian branches and Canadian subsidiary companies of these British insurance companies provide 30% of the general insurance coverage of Canadians. All other non-resident companies located throughout the rest of the world provide 51% of such coverage.

All the Canadian branches of these British insurance companies are registered with the appropriate authorities of the Canadian or provincial governments.

Some of the matters raised in this brief may be of interest to a wider section of the insurance industry than the British companies; however, we do not presume to speak for any other companies because they are competent to speak for themselves.

Present Basis of
Canadian Taxation

The Canadian branches of British insurance companies have paid Canadian income taxes on the underwriting profits earned by them in Canada for many years.

In 1969, the provisions of the Canadian Income Tax Act were changed radically in many respects as they apply to general insurance companies. Income taxes presently payable by these British companies have been increased sharply, although the full impact of this increase cannot yet be estimated due to the involved language of the legislation and regulations issued in respect thereof.

At the present time, British insurance companies carrying on a general insurance business in Canada through Canadian branches must pay the following taxes imposed by the Canadian Income Tax Act:

(1) Annual Canadian and provincial income taxes of approximately 53.4%, based on annual taxable income. Such taxable income includes Canadian underwriting profits and revenues derived from investments used in carrying on business in Canada, and from investments deposited with the Canadian government as a guarantee of solvency in respect of Canadian insurance coverage.

(2) A Canadian tax of 15% based on the balance of the taxable income of the Canadian branch, after deducting the annual Canadian and provincial income taxes. This tax imposes an effective rate of tax of 6.99%.

(3) The appropriate rates of Canadian withholding taxes, usually of 15%, imposed on the Canadian investment revenues not taxed under (1) above derived from additional Canadian investments held directly by British insurance companies.

The income taxes of 53.4% and 6.99%, referred to in the paragraphs numbered (1) and (2) above, impose Canadian taxes of 60.4% on the annual taxable income of the Canadian branches. This compares with the United Kingdom tax of 45% imposed on the United Kingdom measure of the revenues of the Canadian branches.

Accordingly, a British company may pay Canadian income taxes on profits earned in Canada of up to 15.4% in excess of what it pays in its own country, and of course obtains no relief in its own country for this excess tax cost.

Submission

The committee representing the British companies would point out that the tax laws of a country are a vital factor in attracting the business enterprise or capital of non-residents in a highly competitive international market. Failure of one country to keep its tax laws in step with those of other major trading countries can detract from the ability of that country to attract foreign enterprise and investment.

Against this background, the committee wishes to make representations in respect of the following aspects relating to the White Paper:

(A) Dividend tax credit.

(B) Group relief for trading losses.

(C) Transfers of assets within groups of companies.

(D) Operating losses.

(A) Dividend Tax Credit

Reference has already been made to the excess Canadian tax of up to 15.4% over the United Kingdom tax imposed on the annual taxable income, including revenues received by way of

interest and rentals derived from investments used in carrying on business in Canada, of the Canadian branches. Under the existing provisions of the Canadian Income Tax Act, dividends received from Canadian companies are not included in the taxable income of the Canadian branches.

However, the effect of the White Paper proposals will be to impose an even more serious excess Canadian tax of up to 33.75% over the United Kingdom tax rate on that part of investment revenues represented by dividends received on investments in Canadian stocks trusteed with the Minister of Finance or held by the Canadian branches. Such dividends would under the White Paper proposals become subject to Canadian and provincial income taxes of approximately 53.4%. It is also proposed that a dividend tax credit would be given to Canadian shareholders of an amount that varies according to the tax status of the Canadian recipient. However, it is stated in paragraph 4.49 of the Proposals that the government does not propose to give foreign shareholders of Canadian corporations credit for the tax paid by those corporations for the reasons stated in the paragraph.

This paragraph is quoted below:

" 4.49 - The government does not propose to give foreign shareholders of Canadian corporations credit for the tax paid by those corporations. The principal reason for this decision is that the credit to Canadians in respect of corporations that compete in the international area would be given as an incentive to induce Canadians to purchase shares in these corporations. While the government welcomes foreign investment in Canadian corporations, it does not believe it is necessary to subsidize non-residents through the tax system in order to induce them to invest their capital in Canada. Canadian resources, labor and management can compete on even terms for capital with their counterparts in other countries. Because the general tax rule in other countries does not include a credit to the shareholder in respect of taxes paid by the corporation, it is not necessary for Canada to enact such a provision, and it would be quite expensive to do so; an expense that would have to be borne by the Canadian taxpayers."

An example of the present and proposed systems is shown below:

Assume that an investment in a Canadian corporation that earns $200 per share before tax is held by a Canadian branch:

	Present	Proposed
Corporation pre-tax profit	$200	$200
Less: Corporation tax at, say, 50%	100	100
Paid out as dividend	100	100
Tax payable by recipient Canadian branch on dividend received	exempt	50
	100	50
15% branch profits tax	15	7.50
Net amount remaining	$ 85	$ 42.50

In the hands of a United Kingdom insurance company, the dividend will be treated as a receipt of $200, subject to $115 Canadian tax paid under the present system (i.e. a rate of 57.5%). Under the

proposed system, the company would suffer Canadian tax of $157.50 (i.e. a rate of 78.75%) which is 33.75% in excess of the United Kingdom corporation tax rate. No part of this excess would be recoverable.

It is submitted that legislation implementing the White Paper proposals should make it clear that the dividend tax credit should be extended to non-resident insurance companies carrying on business in Canada in relation to the business effectively connected with the permanent establishment.

(B) Group Relief for Trading Losses

The proposals relating to the right of a group of closely-held corporations to elect to be taxed as a partnership, which proposals are set out in paragraphs 4.20, 4.21, 4.22 and 4.23 of the White Paper, restrict the right to make such an election to closely-held corporations, all of whose shareholders must be individuals resident in Canada or must be corporations resident in Canada. This restriction is proposed by paragraph 4.23 of the Proposals which reads as follows:

" 4.23 - For technical reasons, three restrictions must be imposed on corporations that can be treated as partnerships. First, it must be clear what portion of the profits each shareholder is going to receive. This would usually mean that the corporation can have only one class of shares, although there may be instances in which the respective rights of different classes of shareholders would be unchanged by differing future circumstances, including winding up the corporation. Secondly, all shareholders must be individuals resident in Canada or corporations incorporated in Canada. If the profits are to be taxed according to the circumstances of the shareholder, the government must be able to determine what those circumstances are, and whether the person in whose name the shares are registered is in fact the owner of the shares and not a nominee. Finally, if some shares are held by Canadian corporations, those corporations must have the same fiscal year-end as the corporation itself. In the absence of this year-end rule, it would be possible to postpone tax for several years by using a chain of corporations with appropriate year-ends."

Accordingly the right to elect to be taxed as a partnership as proposed in the White Paper will not extend to a group of British insurance companies that carry on business in Canada through Canadian branches, as the ownership of their business cannot meet the tests proposed.

As already stated, the British insurance companies on whose behalf this brief is being filed carry on their respective insurance businesses through several groups which comprise a number of companies under common control and ownership.

Under Section 20 of the United Kingdom Finance Act, 1967, a new conception of group relief was introduced into the United Kingdom legislation whereby, within certain limits, a member of a group of companies could effectively "inherit" the losses for tax purposes of another member of that same group.

The relevant portion of Section 20 is as follows:

> " 20. - Group relief - (1) Relief for trading losses and other amounts eligible for relief from corporation tax may in accordance with Schedule 10 to this Act be surrendered by a company (called "the surrendering company") which is a member of a group of companies and claimed by another company (called "the claimant company") which is a member of the same group by way of a new relief from corporation tax to be called group relief."

We would point out that the British companies for which we speak, because they are taxed in the United Kingdom on their worldwide operations, are concerned to ensure that so far as it is possible the reliefs provided under United Kingdom tax law are matched in the overseas countries in which they operate so as to avoid limitation of double taxation relief.

We would accordingly respectfully submit that Canadian branches of British company groups be given the right to elect in any year to offset a loss in one company against the profit in another company of the same group.

(C) Transfer of Assets Within Groups of Companies

Rationalisation in the insurance industry in the United Kingdom has been quickening a-pace in recent years. The stage has been reached where, although individual companies have continued to transact insurance in their individual names, the Group has looked upon the whole operation as one effective business. In recent years there has been a number of mergers of insurance companies in the United

Kingdom, as a result of which groups have emerged with an unnecessarily large number of companies of the one group operating in a number of territories. The next stage in rationalisation has been a reduction in the number of operating companies in a group. This has been achieved by the withdrawal of some companies and a transfer of their business to other companies within the same group. Recently as many as 14 of such companies have been so withdrawn from Canada.

Schedule 13 of the United Kingdom Finance Act, 1965, Part 1, paragraph 2, provides that a group of companies may transfer assets between companies comprising the group at cost and without such transfer being considered to be a sale or purchase for the purpose of the tax on capital gains imposed by that country. The relevant paragraph is set out below:

> "Notwithstanding any provision in Part III of this Act fixing the amount of the consideration deemed to be received on a disposal or given on an acquisition, where a member of a group of companies disposes of an asset to another member of the group, both members shall, except as provided by subparagraphs (2) and (3) below, be treated, so far as relates to corporation tax on chargeable gains, as if the asset acquired by the member to whom the disposal is made were acquired for a consideration of such amount as would secure that on the other's disposal neither a gain nor a loss would accrue to that other; but where it is assumed for any purpose that a member of a group of companies has sold or acquired an asset, it shall be assumed also that it was not a sale to or acquisition from another member of the group."

We would respectfully submit that Canadian branches of British insurance companies be given the right:

(a) to effect transfers of assets within the group of Canadian branches without attracting any additional Canadian taxes in a similar manner to that which the British companies comprising the same group are so permitted under the United Kingdom legislation;

(b) to effect transfers of assets within the group from Canadian branches to subsidiary companies incorporated under the laws of Canada without attracting any additional Canadian taxes in a similar manner to that which the British companies comprising the same group are so permitted; and

(c) to establish the cost of investments owned by a company within the group at November 7, 1969 at the higher of original cost of the investment to the group or market value on the valuation date (i.e. preserving the benefit of any existing "tax-free run-up" within the group.)

(D) Operating Losses

The present Canadian Income Tax Act permits a business that has incurred an operating loss in a taxation year first to apply that loss against the operating profits of the immediately preceding year. Then, if the profits of the preceding year are less than the loss, to apply the balance of the loss against the operating profits of the five subsequent years.

The authority to deal with operating losses in this manner is contained in Section 27, subsection 1, paragraph (e) of the existing Canadian Income Tax Act.

The Proposals for Tax Reform make no reference to operating losses, so it is presumed that the present law is considered adequate. We would however point out that the Report of the Royal Commission on Taxation in Vol. 4, page 285, proposed that no limitation be placed on the right to apply business losses incurred in one year against operating profits earned in other years. The relevant portion of this report follows:

"Business losses should be subject to the following treatment:

(a) The present provisions for applying losses against other income should be broadened by allowing most losses to be carried back against any income of the two previous years, and carried forward indefinitely against any income of future years.

(b) Some form of consolidation for tax purposes should be permitted for groups of corporations under the same ownership.

(c) Not relevant.

(d) Not relevant."

We would point out that the essence of general insurance business is the spreading of risks. The operations of the companies transacting the business have the effect of evening out the losses which arise as between person and person, territory and territory, one year and another. As a result a company may find in any one territory that its results fluctuate severely from one year

to another between profits and losses. These fluctuations have become more marked as major catastrophes have been experienced. In recent years there have been earthquakes, abnormally severe hurricanes, civil disturbances, bush fires of great intensity. To these must be added the potential disasters which may arise from disintegration of nuclear installations, losses of jumbo jets, mammoth tanker losses and similar occurrences. With the rising potential losses it is essential that adequate provision be made for actual losses experienced to be set off against profitable years' results.

We respectfully submit that the present five-year limitation is not adequate to permit an insurance company transacting general business to recover fully operating losses against future operating profits, and some amelioration of the situation is necessary.

We would also point out that there is an international trend in taxation legislation to liberalize the provision to set off losses against profits. One of the countries that provides for losses to be carried forward indefinitely until fully recovered is the United Kingdom.

This right is granted by Sections 341 and 342 of the Income Tax Act, 1952, as amended by Section 27 of the Finance Act, 1952.

The relevant portions of these sections are:

" 341 - (Income Tax Act, 1952). Right to have income for year of assessment adjusted by reference to losses. - Where any person sustains a loss in any trade, profession, employment or vocation, carried on by him either solely or in partnership, or in the occupation of woodlands in respect of which he has elected to be charged to tax under Schedule D, he may, upon giving notice in writing to the surveyor within two years after the year of assessment, claim relief from tax on an amount of his income equal to the amount of the loss."

" 342 - (Income Tax Act, 1952). Right to carry forward losses to future years. - Where a person has in any trade, profession or vocation carried on by him, either solely or in partnership, sustained a loss to be computed in like manner as profits or gains under the provisions of this Act applicable to Cases I and II of Schedule D in respect of which relief has not been wholly given either under the last preceding section or under any other provision of this Act, he may claim that any portion of the loss for which relief has not been so given shall be carried forward and, as far as may be, deducted from or set off against the amount of profits or gains on which he is assessed under Schedule D in respect of that trade, profession or vocation for any year within the said six following years."

" 27 - (Finance Act, 1952). Removal of limit of time for carrying forward of losses and management expenses. - In section three hundred and forty-two of the Income Tax Act, 1952, which permits trading and other losses to be carried forward for six years -

(a) in subsection (1), for the words 'for the six following years of assessment' there shall be substituted the words 'for subsequent years of assessment'; and

(b) in subsection (3), the words 'for any year within the said six following years' and the word 'such' shall be omitted.

We would therefore respectfully submit that the Canadian branches and Canadian subsidiary companies of British insurance companies carrying on a general insurance business in Canada be permitted an indefinite period in which operating losses incurred in one year can be applied against subsequent operating profits.

Respectfully submitted,

Chairman, Ad Hoc Committee
of British Insurers

Exhibit 1

LIST OF BRITISH INSURANCE COMPANIES REPRESENTED

COMPANY or GROUP	COMPANY REPRESENTED by CANADIAN BRANCH	CANADIAN SUBSIDIARY COMPANIES
1. Aviation & General Insurance Company Ltd.	Aviation & General Insurance Company Ltd.	–
2. The British Aviation Insurance Co. Ltd.	The British Aviation Insurance Co. Ltd.	–
3. Robt. Bradford of Canada Limited	British Merchants' Insurance Co. Ltd.	
	The Contingency Insurance Company Limited	–
4. Co-operative Insurance Society Limited	Co-Operative Insurance Society Limited	–
5. Eagle Star Group	Eagle Star Insurance Company Limited	British Northwestern Insurance Co.
6. Commercial Union Group	Commercial Union Assurance Company Ltd.	The Canada Accident and Fire Assurance Company
	North British & Mercantile Insurance Company Limited	
	The Ocean Accident & Guarantee Corporation Limited	
	The Employers' Liability Assurance Corporation Limited	
	London and Scottish Assurance Company Ltd.	
	The Northern Assurance Company Limited	

Exhibit 1
page 2

COMPANY or GROUP	COMPANY REPRESENTED by CANADIAN BRANCH	CANADIAN SUBSIDIARY COMPANIES
7. Dale and Company Limited	The Orion Insurance Company Limited	
	Excess Insurance Company Limited	-
8. Economic Insurance Company Limited	Economic Insurance Company Limited	-
9. General Accident Group	General Accident Fire and Life Assurance Corporation Limited	General Accident Assurance Company of Canada
	The Yorkshire Insurance Company Limited	Scottish Canadian Assurance Corporation
		Canadian Pioneer Insurance Company
10. Guardian Royal Exchange Group	Guardian Assurance Company Limited	The Guardian Insurance Company of Canada
	Union Insurance Society of Canton Limited	Beaver Insurance Company
	The Insurance Corporation of Ireland Ltd.	United Canada Insurance Company
	Royal Exchange Assurance	Caledonian—Canadian Insurance Co.
	The State Assurance Company Limited	
11. Independent Insurance Managers Limited	Cornhill Insurance Company Limited	The Canadian Provincial Insurance Co.
	Provincial Insurance Company Limited	
12. London & Edinburgh General Insurance Company Limited	London & Edinburgh General Insurance Company Limited	-
13. Wm. H. McGee and Company Limited	English & American Insurance Company Limited	
	The Indemnity Marine Assurance Company Limited	-

Exhibit 1
page 3

COMPANY or GROUP	COMPANY REPRESENTED by CANADIAN BRANCH	CANADIAN SUBSIDIARY COMPANIES
14. Norwich Union Insurance Group	Maritime Insurance Company Limited	Canada Security Assurance Company
	Norwich Union Fire Insurance Society Limited	
	The Scottish Union & National Insurance Company	
15. Pearl Assurance Company Limited	Pearl Assurance Company Limited	-
16. Phoenix of London Group	Phoenix Assurance Company Limited	The Acadia Insurance Company
	The Union Marine and General Insurance Company Limited	The Acadia Life Insurance Company
17. The Prudential Assurance Company Limited	The Prudential Assurance Company Limited	-
18. Royal Insurance Group	Law, Union and Rock Insurance Company Ltd.	British America Assurance Company
	The Liverpool and London and Globe Insurance Company Limited	The Globe Indemnity Company of Canada
	The London & Lancashire Insurance Company Limited	The Hudson Bay Insurance Company
	Royal Insurance Company Limited	Imperial Guarantee & Accident Insurance Company of Canada
		Quebec Assurance Company
		The Western Assurance Company

Exhibit 1
page 4

COMPANY or GROUP	COMPANY REPRESENTED BY CANADIAN BRANCH	CANADIAN SUBSIDIARY COMPANIES
19. Sun Alliance & London Insurance Group	The London Assurance	Guildhall Insurance Company of Canada
	Alliance Assurance Company Limited	Imperial Insurance Office
	Sun Insurance Office Limited	The Citadel Insurance Company of Canada Limited
20. Lombard Insurance Company Limited	Lombard Insurance Company Limited	-
21. Queensland Insurance Company Limited	Queensland Insurance Company Limited	-
22. United Insurance Managers Limited	Bankers & Traders' Insurance Company Limited	
	National Employers' Mutual General Insurance Association Limited	-
23. Sterling Offices of Canada Limited	The Reinsurance Corporation Limited	
	The Victory Insurance Company Limited	-
24. The Mercantile and General Reinsurance Company Limited	The Mercantile and General Reinsurance Company Limited	The Mercantile and General Reinsurance Company of Canada Ltd.

Exhibit 2

LIST OF CANADIAN SUBSIDIARY COMPANIES

The Acadia Insurance Company

The Acadia Life Insurance Company

Beaver Insurance Company

British America Assurance Company

British Northwestern Insurance Company

Caledonian-Canadian Insurance Company

The Canada Accident and Fire Assurance Company

Canada Security Assurance Company

Canadian Pioneer Insurance Company

The Canadian Provincial Insurance Company

The Citadel Insurance Company of Canada Limited

General Accident Assurance Company of Canada

The Globe Indemnity Company of Canada

The Guardian Insurance Company of Canada

Guildhall Insurance Company of Canada

The Hudson Bay Insurance Company

Imperial Guarantee & Accident Insurance Company of Canada

Imperial Insurance Office

The Mercantile and General Reinsurance Company of Canada Limited

Quebec Assurance Company

Scottish Canadian Assurance Corporation

United Canada Insurance Company

The Western Assurance Company

APPENDIX "H"

NAME: AD HOC COMMITTEE OF BRITISH INSURANCE COMPANIES

SUBJECT: Taxation of Non-resident Companies that carry on a General Insurance Business in Canada through Branches located here.

Analysis of Appendix "G" by Senior Advisor

This brief has been filed by an Ad Hoc committee representing 48 British general insurance companies that carry on business in Canada through branches located here. These companies furnish 30% of the general insurance coverage purchased by Canadians. Other non-resident companies located throughout the rest of the world furnish 51% of such coverage.

The Canadian government requires that a non-resident general insurance company doing business in Canada must maintain assets in Canada under the control of its chief agent here to meet its costs and liabilities arising in the daily course of its business.

In addition, the non-resident company must deposit securities with the Canadian Minister of Finance of a value equal to the amount of its outstanding claims and unearned premiums. These deposits are required as a guarantee of the solvency of the non-resident company, and are beyond its control when so deposited.

In all the long history of operations by British insurance companies in Canada, no policyholder has had to claim against these deposits.

Prior to 1969, the revenues earned by the non-resident companies from securities deposited with the Minister of Finance were generally not subjected to Canadian tax, although, of course, these

revenues were subjected to tax in the United Kingdom. Underwriting profits, or losses, have always been included in Canadian taxable income.

Commencing in 1969, the British non-resident insurance companies have become liable to pay the following Canadian taxes:

	Annual Income Taxes	Branch Profits Taxes	Total Canadian Tax
(1) On underwriting profits or losses	53.4%	15% of 46.6% or 6.99%	60.39%
(2) On interest and rental income derived from securities deposited with the Minister of Finance	53.4%	6.99%	60.39%
(3) On dividends derived from Canadian stocks deposited with the Minister of Finance	∅	15%	15%

Investments held directly by the non-resident company, and not deposited with the Minister of Finance, are subject only to the usual Canadian withholding taxes.

It may be added that no other type of non-resident business carried on through a Canadian branch is subject to a Canadian tax on investment revenues in excess of 15%.

The discriminatory taxes levied on investment revenues of 60.39% exceed the taxes payable in the United Kingdom on the same revenues by 15.4%.

The brief itself deals with the following subjects:

(1) A brief description of the companies represented.

(2) A summary of the Canadian taxes presently payable by British insurance companies, and is followed by references to specific sections of the White Paper, comprising:

(3) The proposal in paragraph 4.49 to deny any Canadian dividend credit to Canadian dividends received by the British insurance companies. This will result in the imposition of a Canadian tax of 60.39% instead of the present tax of 15% on Canadian dividends payable by the Canadian branch.

(4) The proposal in paragraph 4.23 to deny the British insurance companies the right to elect to be taxed as a partnership group. This section requests the right to transfer losses within a group of companies in the manner permitted in the United Kingdom.

(5) The capital gains tax proposals in the White Paper. This section requests the right to transfer assets within a group of companies without tax consequences in the manner permitted in the United Kingdom.

(6) The failure of the White Paper to make any proposal respecting the carry-forward of business losses. This section of the Brief requests an indefinite carry-forward of losses incurred by British insurance companies in the manner permitted in the United Kingdom.

The taxes imposed by the 1969 legislation, and the additional tax on dividends proposed by the White Paper will add to the discriminatory taxes imposed on British general insurance companies, and will certainly render Canada a less desirable place for insurance operations and may endanger the continued investment in immense sums of Canadian securities deposited with the Canadian Minister of Finance.

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: COMMITTEE OF BRITISH INSURANCE COMPANIES

Date Brief Received:

Principal Subject: Canadian Dividend Credits

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 28-1 of the Income Tax Act This section permits a non-resident company which carries on business in Canada to deduct from its Canadian taxable income any dividends received from other Canadian companies.	4.49 The government does not propose to give foreign shareholders of Canadian corporations credit for the tax paid by those corporations. The principal reason for this decision is that the credit to Canadians in respect of corporations that compete in the international area would be given as an incentive to induce Canadians to purchase shares in these corporations. While the government welcomes foreign investment in Canadian corporations, it does not believe it is necessary to subsidize non-residents through the tax system in order to induce them to invest their capital in Canada. Canadian resources, labor and management can compete on even terms for capital with their counterparts in other countries. Because the general tax rule in other countries does not include a credit to the shareholder in respect of taxes paid by the corporation, it is not necessary for Canada to enact such a provision, and it would be quite expensive to do so; an expense that would have to be borne by the Canadian taxpayers.	Page 4 of Brief This portion of the brief asks that the present system be continued.

Name: Committee of British Insurance Companies

Date Brief Received:

Principal Subject: Partnership of Canadian Companies

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The provisions of the present Income Tax Act do not permit the transfer of a loss incurred by one company to another company that has earned a profit.	4.23 For technical reasons, three restrictions must be imposed on corporations that can be treated as partnerships. First, it must be clear what portion of the profits each shareholder is going to receive. This would usually mean that the corporation can have only one class of shares, although there may be instances in which the respective rights of different classes of shareholders would be unchanged by differing future circumstances, including winding up the corporation. Secondly, all shareholders must be individuals resident in Canada or corporations incorporated in Canada. If the profits are to be taxed according to the circumstances of the shareholder, the government must be able to determine what those circumstances are, and whether the person in whose name the shares are registered is in fact the owner of the shares and not a nominee. Finally, if some shares are held by Canadian corporations, those corporations must have the same fiscal year-end as the corporation itself. In the absence of this year-end rule, it would be possible to postpone tax for several years by using a chain of corporations with appropriate year-ends.	Page 7 of Brief This portion of the brief asks that losses incurred by one company in a group of companies be transferable to other companies in the same group in the manner permitted by the tax laws of the United Kingdom.

Name: Committee of British Insurance Companies

Date Brief Received:

Principal Subject: The Capital Gains Tax

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The provisions of the present Income Tax Act do not levy a tax on capital gains.	The White Paper proposals respecting Capital gains taxes have been referred to in the Special Study of February 11, 1970.	Page 9 of Brief This portion of the brief suggests: (a) to effect transfers of assets within the group of Canadian branches without attracting any additional Canadian taxes in a similar manner to that which the British companies comprising the same group are so permitted under the United Kingdom legislation; (b) to effect transfers of assets within the group from Canadian branches to subsidiary companies incorporated under the laws of Canada without attracting any additional Canadian taxes in a similar manner to that which the British companies comprising the same group are so permitted; and

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(c) to establish the cost of investments owned by a company within the group at November 7, 1969 at the higher of original cost of the investment to the group or market value on the valuation date (i.e. preserving the benefit of any existing "tax-free run-up" within the group.)

Name: Committee of British Insurance Companies

Date Brief Received:

Principal Subject: Carry Forward of Business Losses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 27-1-e of the Income Tax Act This section permits a business loss incurred in a year to be applied against the profits of a preceding year or profits of the five following years.	The White Paper makes no reference to business losses.	Page 11 of Brief This portion of the brief asks that non-resident general insurance companies be permitted to be deducted from the profits of subsequent years for an indefinite period.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 19

WEDNESDAY, APRIL 29th, 1970

Thirteenth Proceedings on the Government White Paper,

entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 19:5)

APPENDICES:

"A"—Brief from Hollinger Mines Limited.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from Syncrude Canada Ltd.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from the Canadian Potash Producers Association.
"F"—Analysis of Appendix "E" by Senior Advisor.
"G"—Brief from Bethlehem Copper Corporation Ltd.
"H"—Analysis of Appendix "G" by Senior Advisor.

21851—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis—(29)
Croll	Isnor	

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21851—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, April 29th, 1970.
(26)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Blois, Burchill, Connolly (*Ottawa West*), Cook, Flynn, Everett, Gélinas, Macnaughton, Martin, Molson, Phillips (*Rigaud*) and Walker—(15).

Present, but not of the Committee: The Honourable Senators Fournier (*Madawaska-Restigouche*), Hastings, Laird and Methot—(4).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Hollinger Mines Ltd.

Mr. A. L. Fairley, Jr., President;
Mr. P. Finley, Vice-President & General Counsel;
Mr. F. Hunt, Treasurer, Labrador Mining Co.

Syncrude Canada Ltd.

Mr. F. K. Spragins President & General Manager;
Mr. P. N. Thorsteinsson, Tax Advisor.

Canadian Potash Producers Assn.

Mr. B. E. Hurdle, President;
Mr. R. Holzkaenper, Managing Director;
Mr. E. K. Cork, Vice-President & Treasurer;
Mr. B. Carlson, Vice-President & Comptroller;
Mr. V. C. Wansbrough, Executive Director.

At 12:15 p.m. the Committee adjourned.

AFTERNOON SITTING

2:00 p.m.
(27)

At 2:00 p.m. the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Blois, Burchill, Connolly (*Ottawa West*), Cook, Everett, Gélinas, Molson, Phillips (*Rigaud*) and Welch—(12).

Present but not of the Committee: The Honourable Senators Laird, Smith and Sparrow—(3).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Bethlehem Copper Corporation Ltd.

Mr. P. M. Reynolds, President & Chief Executive Officer;
Mr. W. J. Thiessen, Secretary and Chief Legal Officer;
Mr. K. E. Steeves, Vice-President—Finance;
Mr. J. Bruk, Solicitor.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Hollinger Mines Limited.
B—Analysis of Appendix "A" by Senior Advisor.
C—Brief from Syncrude Canada Ltd.
D—Analysis of Appendix "C" by Senior Advisor.
E—Brief from the Canadian Potash Producers Association.
F—Analysis of Appendix "E" by Senior Advisor.
G—Brief from Bethlehem Copper Corporation Ltd.
H—Analysis of Appendix "G" by Senior Advisor.

At 3:00 p.m. the Honourable Senator Phillips (*Rigaud*) assumed the Chair as *Acting Chairman.*

At 3:45 p.m., the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

ERRATUM: The Title Page of Issue No. 18, dated Wednesday, April 22nd, 1970, should read as follows:

"*12th* Proceedings on the Government White Paper,".

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, April 29, 1970

The Standing Senate Committee on Bankin, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have four submissions this morning, and the suggestion is that we deal first with Hollinger Mines Limited, then with Syncrude Canada Limited, Canadian Potash Producers Association, and Bethlehem Copper Corporation Limited. We will see how far we get this morning.

On Hollinger Mines Limited we have Mr. A. L. Fairley, Jr., President; Mr. P. Finley, Vice-President and General Counsel; and Mr. F. Hunt, Treasurer, Labrador Mining Company.

This is Mr. Fairley who is going to lead the discussion, and he will present his panel to you.

Mr. A. L. Fairley, Jr., President, Hollinger Mines Limited: Honourable senators, as Senator Hayden has said, next to me is Mr. P. Finley, Vice-President and General Counsel of Hollinger Mines. Next to him is Mr. Foster Hunt, the Assistant Treasurer of Hollinger Mines, and Treasurer of Labrador Mining and Hollinger North-Shore Exploration, controlled subsidiaries of Hollinger. Next is Mr. John P. Kinghorn, Auditor with Riddell Stead, who are the public auditors for Labrador Mining and Hollinger North Shore. I hope that between all of us we will be able to answer any questions you may have, after I have made an opening statement.

Honourable senators, as a preface I wish to express the sincere appreciation of my colleagues and myself for the opportunity to appear before you today to discuss the implications of the White Paper on Proposals for Tax Reform as they apply to the Canadian mining industry in general and Holinger in particular. I am entirely convinced that the ultimate disposition of these proposals will have a profound effect, not only on the future of the mining industry in Canada, but also on the future of Canada and Canadians for generations to come. It is our conclusion that, if implemented, the White Paper proposals would destroy the vigour and usefulness of this unique Canadian industry and impose unnecessary and tragic limitations on the future well-being of Canada and the Canadian economy.

Our brief, which you have before you, makes apparent our opposition to the White Paper proposals with respect to the existing three-year tax-exempt period on new mines and the existing depletion allowance on the income derived from the operation of a mine. A further objection, implied in the memorandum attached as an appendix to our brief, is entered against the proposals which would, for dividend tax purposes, treat the Iron Ore Company of Canada, one of our associates, as a foreign corporation.

Hollinger has been a senior member of the Canadian mining community for more than half a century and self-interest alone would induce us to oppose the introduction of a tax structure which we believe to be harmful and inadequate to this enterprise. We oppose the proposals of the White Paper on this basis, but additionally we believe the implications of these proposals go far beyond the self-interest of any one mining company to threaten a basic, national industry. In doing this, they introduce a completely unnecessary and unprofitable hazard to the future economic well-being of Canada.

Apparently the authors of these proposals did not understand the national value of a vigorous mining industry in Canada. However, it is there and is measurable in terms of employment, regional development, new sources of revenue and the generation of foreign exchange. I also find it hard to believe that they understood the high risk nature of

the industry or the intensity of international competition for the capital necessary to develop mining enterprises. Furthermore, I find no awareness in these proposals of the potential possessed by many other countries to develop or expand their mineral production or the favourable tax climate many of these countries are providing to encourage the development or expansion of this high risk industry within their own borders. To survive at its present level, or to reach the potential wich it should reach, the Canadian mining industry must meet successfully intense international competition, not only for development funds, but for mineral markets. Other competitor countries such as Ireland, South Africa, Australia and particularly the United States are aware of these conditions and have tax structures designed to encourage their national mining industries.

It is against this background that we believe the proposals of the White Paper with respect to the tax-exempt period on new mines and the depletion allowance on income derived from a mining operation to be wrong for Canada in principle and in detail.

The existing provision for a three-year tax exemption on new mines is a necessary and measurably useful element in our tax structure, which serves to interest investment capital in this industry. Any major modification of this element will reduce the attractiveness of the Canadian industry for development capital and increase the attractiveness of many competitor countries for this form of investment. If this comes about Canada will be penalized, competitor countries will be benefitted. The accelerated depreciation proposed as a substitute is merely a token gesture. It has some value, of course, but essentially it simply makes an existing provision somewhat more attractive. It does nothing to compensate for the loss of the three-year tax exemption.

We believe that the existing provision for depletion allowance on income derived from a mining operation is another element that must be retained in our tax structure if the Canadian mining industry is to maintain its present stature. One of the purposes of this provision is to compensate for a characteristic that is unique in this industry; an ore body, the raw material of the mining industry, does not renew itself. The process of exhaustion begins as soon as mining starts. It continues until the orebody is consumed. This unique characteristic is recognized and provisions have been made for it in the tax structures of all countries which have developed and maintained a major mining industry. This allowance has also served to provide funds to enable the industry to invest in mechanized equipment and technological developments which have allowed it to remain competitive with countries using similar provisions for the same purpose. Additionally, it helps to make possible a rate of return on investment necessary for high risk capital. The elimination or proposed modification of this provision would have a severely adverse effect on Hollinger earnings as it would on other mining companies.

The alternative advanced by the proposals of the White Paper falls far short of essential needs. Incidentally, we do not understand how the formula of the White Paper of $1.00 depletion for $3.00 spent on exploration was reached; nor do we understand why this formula, inadequate though it is, is limited to new ore bodies and does not apply to the expansion of existing operations. Without further speculation on these aspects we wish to say emphatically that the proposal fails as a substitute for an existing tax provision that is essential to the industry. Any departure from the existing principle that recognizes the constantly diminishing nature of the raw material of mining, will have the effect of discouraging the investment which could and should launch new mining enterprises.

The White Paper also contains proposals with respect to the definition of foreign-owned corporations and the taxability of dividends paid by these corporations. As mentioned earlier this matter is set out in a memorandum attached as an appendix to our brief. It is important to Hollinger because of our investment in the Iron Ore Company of Canada—an enterprise, I wish to add, that came into being as a result of Hollinger's extensive exploration activities in the Labrador Iron Trough. I would also add that this matter has been discussed with the Minister of Finance who indicated that he understood the problem and felt a satisfactory solution could be found. For the record, however, I wish to say that if the dividends from this company are taxed as those of a foreign-owned corporation, it would represent a unilateral rejection of an element of an international tax treaty negotiated between Canada and the United States that would bring about a severe reduction of income to Hollinger and Hollinger shareholders.

The ultimate effect of the implementation of the White Paper would be to raise tax

levels, inclusive of provincial taxes, on the high-risk mining industry above those of the more secure manufacturing industry. The effect on Hollinger, as one member of the Canadian mining community, would be a severe reduction in earnings. The loss of the depletion allowance by Iron Ore Company of Canada would reduce Iron Ore dividends to Hollinger. The taxability of these dividends under the "foreign corporation" proposal would further reduce income from this source to Hollinger. The income of Hollinger's subsidiaries would be likewise reduced in proportion to their interest in Iron Ore Company.

Inference with respect to the nationally harmful aspects of these proposals may be drawn from two circumstances related to Hollinger operations. Our associate, the Iron Ore Company of Canada, is contemplating a major expansion in the Labrador Trough involving several hundred million dollars. If this project goes forward it would represent new employment opportunities, new sources of tax revenue, and increased foreign exchange to Canada.

Senator Connolly (Ottawa West): Is the ore body in existence now, do you know?

Mr. Fairley: In Labrador?

Senator Connolly (Ottawa West): Yes.

Mr. Fairley: Yes, it is in existence.

Senator Connolly (Ottawa West): In other words, you have found it and, therefore, you do not get the $1 depletion for every $3 spent?

Mr. Fairley: That is right.

The prospects of this expansion will be jeopardized by implementation of the proposals of the White Paper, but would be enhanced by the continuation of the present incentives.

Additionally, since its inception Hollinger has annually devoted large sums of the search for new mineral deposits. This search has been conducted almost exclusively in Canada. If the proposals of the White Paper are enacted into law it will no longer be prudent to concentrate this expenditure in Canada and much of it will be diverted to the search for new mineral deposits in countries that offer a more favourable economic climate and opportunity to the mining industry.

Senator Laird: Which countries, for example?

Mr. Fairley: A typical example would be Ireland, or South Africa, or Australia, or even, strangely enough, the United States.

We believe that the three-year tax exemption and the depletion allowance must be retained in their present form to maintain a viable industry in Canada.

Thank you, Mr. Chairman and gentlemen. If there are any questions that any of us can answer, then we shall be pleased to do so.

Senator Connolly (Ottawa West): I am interested in the statement you made in your last sentence. Would you tell us the history of this kind of proposal in the United States in relation to the iron ore industry?

Mr. Fairley: Do you mean in respect of the depletion allowance?

The Chairman: Is that what you mean, senator, or do you mean the international arrangement to which he referred?

Senator Connolly (Ottawa West): No, that is another question, Mr. Chairman. I just want to know what the American arrangement was.

Mr. Fairley: So far as I know, there has been no proposal in the United States to do away with the depletion alowance. I do not claim to be an expert on the American situation at the moment, so I will ask Mr. Finley to speak to that in a minute, but I would like to say first that within the last year, as you know, the tax laws in the United States have been changed by Congress but they were changed very little. And the present time the law in the United Sates on depletion states, in a word, that depending upon what mineral you are talking about the allowed depletion is a certain percentage of the total value of your income from the sale of that mineral, which varies anywhere from about ten per cent to 15 per cent. So, you are allowed 50 per cent of your taxable income, whichever is the lower. Now, as a practical matter, in mine out of ten cases the 50 per cent of the taxable income is the controlling figure. So, in the United States you are allowed as a depletion today under the new law 50 per cent of your taxable income as depletion.

Mr. Finley, would you care to comment further on that?

Mr. P. Finley, Vice President and General Counsel, Hollinger Mines Limited: I do not think there is much more to comment on, other than the case of the minerals, silver,

gold, iron ore and copper. They are retained at 15 per cent of the gross. This is the recent legislation. Domestic depletion is reduced to 14 per cent of the gross where they were operating in foreign countries. One slight change was made there, but it is still 15 per cent of the gross, or 50 per cent of the net. It seems as far as iron ore or copper is concerned it is logical over the period of the life of a mine to calculate the depletion on 50 per cent of the net. Which one might be more advantageous would depend on costs in bringing a mine into production. However, this was dealt with exhaustively in the United States in the last couple of years. They made absolutely no change in regard to the major minerals with which we are concerned.

The Chairman: Mr. Finley, in the United States it is still written right into the law that depletion is to take care of wastage.

Mr. Finley: Yes.

The Chairman: That is the principle and has always been so.

Mr. Finley: Yes.

Senator Beaubien: Which is the most favourable, the American law or the Canadian law as it stands now?

Mr. Finley: The American law as it stands now, I suppose. It depends on your operation to a certain extent.

Senator Burchill: Does that apply to every state?

Mr. Finley: It is federal law.

Senator Burchill: Do the states have no individual mining taxing law, as we have here?

Mr. Finley: The states have the same as our provinces.

Mr. Fairley: They vary from state to state.

Senator Beaubien, with reference to your question, the depletion allowances in the United States are better now than they are at present in Canada even without the White Paper. We have the additional aspect which they do not have there, the three year tax exemption. That helps balance it up between the two. It is six of one and half a dozen of the other.

The Chairman: You referred to a tax treaty in connection with iron ore.

Mr. Fairley: Yes.

The Chairman: This is not the legal use of the term tax treaty, but an arrangement.

Mr. Fairley: I will ask Mr. Finley to speak to that, as he was involved in the negotiations about 15 years ago and up to the present time.

Mr. Finley: The relevant part of the main brief is at the end, entitled "Memorandum", which was submitted to the minister, Mr. Benson, in November. It deals very clearly with the history of how the Iron Ore Company came into being. The original part of that country was explored by two subsidiaries of Hollinger, Hollinger North Shore, a Quebec company, and the Labrador Mining and Exploration Company Limited, a Labrador company. The aim started back in 1942, the last month of 1941. Eventually it materialized that we had to develop, before there was any possibility of financing, 300 million tons of open pit, high grade, direct shipping ore. That aim was eventually realized, but then came the problem of financing that vast amount of dollars and work. It was 300-odd miles north of Seven Islands, a very small place at the time, with no railroad. The result was that there was no possibility of financing anything of that description. The ultimate financing at the end of 1968 amounted to $622,526,000, of which $158,200,000 was re-invested earnings.

The negotiations went on in this way. First of all, you could not bring this property into production unless you had someone who would buy your product. At that time, 1951, Canada was probably using four or five million tons of iron ore. There was no possibility of a Canadian market then, or even now, to take care of the production. It ended up that six United States steel companies gave 25-year contracts to buy the iron ore and to take an equity interest in the company. Negotiations continued. It is only fair to say that the Canadian interests wished to have a Canadian company. They could not get it, because of logical reasons and because of the negotiations that ensued, to which the Canadian Government was a party.

Article XII (2) of a convention between Canada and the United States still exists. The American people who were financing this, the steel companies, were insistent on an American company because of their tax laws. This was by no means at that time a favourable outlook on which to develop it. It was helped, of course, by the exhaustion of high grade

reserves in the United States at that particular time due to the war. Therefore, there was no way in which we could do it except by negotiating a deal. The deal resulted in the formation of an American company. It was agreed, and this is what the chairman referred to as an arrangement rather than a contract, that the Iron Ore Company would return all its revenue, carry on all its operations in Canada and be classed as a resident Canadian company. Therefore, being a resident Canadian company, it qualified under our Income Tax Act so that the dividends from Iron Ore Company of Canada could be paid to Hollinger, Labrador and Hollinger North Shore Company, who were all Canadian companies.

The vast majority, 85-odd per cent, of the Hollinger shareholders are Canadian. Therefore it was extremely important to Hollinger. We could not possibly agree to it unless this was done. The Americans came back and said they had to get rid of this 15 per cent deduction. Considering the American situation, if they had had a Canadian company they would have had, subject to credits, to pay full American tax on everything that went there. Now when they get it they can transfer from one American company to another for the usual corporate tax of 15 per cent of the moneys they receive from Iron Ore. They and we insisted on this. We also insisted on them operating entirely in Canada. The Canadian government went along with this and with bringing in article XII (2) of the reciprocal agreement, under which we have operated ever since. This is why we say that this was settled in 1951, this part of our financing agreement, and it is why the new 4.66 in the White Paper will deprive Hollinger, as well as the Iron Ore Company, of any of these concessions, let alone the question of depletion or the three-year exemption. This is simply on the dividend question.

By the White Paper they have given the Iron Ore Company of Canada five years to become a Canadian company if Hollinger is to be able to get tax credits for the taxes paid by Iron Ore. We therefore have the anomalous situation that Iron Ore, if it remains an American company, will be paying full Canadian taxes, and under section 4.66 of the White Paper Hollinger will have half of their income taken away from them, half of their dividend income from Iron Ore. This was submitted to the minister and, to be frank with you, his answer was, "We cannot do that". We want to be so sure that it is clearly understood that an American company operating entirely in Canada, that pays full Canadian taxes on every dollar it earns in Canada, must if this White Paper is to go through get credit for the dividends in Hollinger.

To take an example, in 1968 I think Hollinger got a $4 million dividend. Leaving aside the question that under the White Paper Iron Ore would not be able to pay as big a dividend as far as we are concerned, even taking the $4 million figure, it would come into Hollinger and Hollinger would pay $2 million on this hypothetical 50 per cent tax referred to in the White Paper. Therefore, Hollinger would end up with $2 million for distribution to their shareholders instead of $4 million, all because of a technicality, because Iron Ore of Canada, which is a New Jersey corporation, is in reality and under the Income Tax Act, and always has been, classed as a resident Canadian corporation, gets the same benefits and has the same obligations, and we in turn get the same benefits and have got the same benefits on the flow through of dividends.

The Chairman: Was it the minister who said "We cannot do that"?

Mr. Fairley: Perhaps I should explain. The minister said, "We cannot allow this to happen", what is said in the White Paper. The minister gave us a verbal assurance that he would try to do something to maintain the situation as it is. I think in all fairness I should say that about the minister.

Mr. Finley: I am sorry if I misstated it.

The Chairman: No, I just wanted to clarify it. I did not know who the "We" was, the Government or you.

Mr. Finley: That is what we understood. When he saw this picture set out in the memorandum in Schedule 3 to our brief, his words were, "We cannot do that. We have to find some way around that." I do not say he said this; I am saying this, because it is an absolute breach of the arrangement made. Not only that, but it is absolutely unfair to the Iron Ore Company, which does pay all their taxes in Canada on every dollar, including any small investment income they may have.

Senator Phillips (Rigaud): Do you accept the observation of the minister with a degree of optimism?

Mr. Fairley: I think that puts it fairly well. We accept the observation, or must accept it,

with some optimism. There is nothing in writing though. All we have is his word that he agrees something should be done about this.

Senator Connolly (Ottawa West): Can you pinpoint the agreement between the participating shareholders of Iron Ore and the Government of Canada?

Mr. Finley: I could pinpoint it in the year 1951, when we had the negotiations. The negotiations between Ottawa and the United States were part of the whole picture. It culminated in 12(2) of the reciprocal agreement being entered into.

Senator Laird: You mean of the treaty?

Mr. Finley: Yes.

Senator Connolly (Ottawa West): Is that in the Income Tax Act?

Mr. Finley: It is not in the Income Tax Act. Maybe my phraseology is wrong. There was a reciprocal agreement between Canada and the United States which is part of the income tax agreement.

Senator Connolly (Ottawa West): In respect of the operation of this American company that is exploiting iron ore resources in Labrador and Quebec...

Senator Cook: It has in effect been treated as a Canadian company.

Mr. Finley: It has been treated as a Canadian company ever since 1951 when it went into production.

Mr. Fairley: This is all set out in the international treaty.

The Chairman: I note that you refer to Article 12 of the Tax Convention between Canada and the United States. You mentioned subsection (2). There was an amendment to Article 12 in 1950. This is the one you refer to?

Mr. Finley: Yes.

The Chairman: It was by reason of this tax convention, which would supercede whatever our income tax law was, that you have obtained the recognition for Iron Ore, that it would be treated as a Canadian company. Is that right?

Mr. Finley: Yes, Mr. Chairman. This is not evidence, but on page 10 of the schedule to our brief, to be frank with you, there is an analysis of my brief at the time this was entered into, the statement of the law as it existed at that time.

Senator Connolly (Ottawa West): So the net effect of Article 12(2) of the Tax Convention of—1952 is it?

Mr. Finley: 1950

Senator Connolly (Ottawa West): If the White Paper is implemented that section now would have to be abrogated.

The Chairman: You must remember the statute that supports any tax convention when it comes to us approves of the tax convention, which is attached as a schedule to the act, and the statute itself provides that where there is a conflict between the convention and the law the terms of the convention apply. Therefore, if they are going to introduce changes I would think that, whatever the statute does, it would have to say that notwithstanding the provisions of any tax convention this is the law, and that would be abrogating the tax convention.

Senator Connolly (Ottawa West): The effect of what these gentlemen say is that the rules are being changed in the middle of the game, because I take it those resources are still quite vast.

Mr. Fairley: Yes, sir.

Senator Connolly (Ottawa West): The actual de-limitation of the ore body as it exists could continue to be exploited for some years. Is that true?

Mr. Fairley: We could double the size of our operation. We have at least 100 years' supply if we double the size of our operation.

Senator Connolly (Ottawa West): I take it the burden of your argument is that to double the size of your operation you would have to continue under the same rules?

Mr. Fairley: That is right, we would have to.

Senator Connolly (Ottawa West): Particularly as to depletion.

Mr. Fairley: Yes, that is right.

Senator Connolly (Ottawa West): The three-year exemption has gone now but the depletion remains?

Mr. Fairley: That is correct. The depletion is the main factor as far as we are concerned.

We have the three-year exemption there from time to time when we go into a new area, a new mine within the same broad area that has not been delimited.

Senator Phillips (Rigaud): I have two questions to put before you, and I think this should be read into the record. There are some references to the mining and petroleum industries in the White Paper which are ambivalent in their approach. First of all, you have the recognition of the importance of these industries, which I suppose you could call the blessing of Jacob. Then you are introduced to the proposed new rules, which you might call the curse of Esau. Referring first to the blessing of Jacob, in section 5.24 on page 64 we read the following:

> ...It is recognized that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts.

That, of course, is confirmed with approval and concurrence in your brief and I will come back to that later.

The first question I have is related to the fact that your brief is somewhat more rigid than that of two briefs we have heard before, one from the Noranda people and the other from the McIntyre Porcupine people, which, though violently objecting to the proposed changes, did emphasize some preferences in terms of what should be retained under the present system as against the retention of the whole. In view of the conclusions in your brief where you say that no changes should be made whatsoever, I can understand the logic of a firm position on the theory that an admission leads to the loss of a case. On page 3 of your brief you say:

> It is our opinion that the tax provisions now applicable to the industry should not be changed.

The assumption is that some changes are to be made, because apparently the White Paper, although not an intent, reflects the state of mind in at least some government circles, an assumption that a change has to be made and will be made. But what type of change could you give without being too satisfied with it.

Mr. Fairley: The most important single item in the present tax law to us is the present handling of depletion. We feel that the present depletion allowance must be maintained. We think that the three-year exemption is highly important, but to us it is not as important as the depletion allowance.

Senator Phillips (Rigaud): Thank you very much.

The Chairman: This was the position Noranda took when they were here. Can I follow that up for one second? Which depletion are you talking about, the depletion which now exists in the law or what is called earned depletion under the White Paper?

Mr. Fairley: I am speaking of the depletion as now exists in the law, the so-called earned depletion. As I say in my statement here we cannot figure out how they arrived at such a formula and we have never been told. The so-called earned depletion under the White Paper is almost useless. It would end up by giving the average mining company, certainly as far as we are concerned, only about 10 per cent of the depletion that we now get.

We do a good deal of exploration. We spend about 10 per cent of our net average tax income every year on what we would call wildcat exploration, looking for new ore bodies, not just to develop the ones that we know about, but new areas.

Senator Beaubien: How much is that?

Mr. Fairley: About a million and a quarter dollars a year. Last year the earnings were difficult because of the strike. Generally we earn \$12 or \$13 million a year. We have been on a gradually decreasing basis. We spend between \$1 million and \$1½ million. \$1¼ million would be a good average. This would give us only about 10 per cent of the depletion we are now getting. It would just be very hurtful for Hollinger Mines and cause a very sharp reduction in our earnings.

Senator Connolly (Ottawa West): Pinpointing this to the ore body you spoke about originally, is this the Iron Ore Company?

Mr. Fairley: That, by the way, is several ore bodies.

Senator Connolly (Ottawa West): Yes, but they are all delimited. There is no possibility of earning a dollars depletion in respect to them under the White Paper formula.

Mr. Fairley: As we read the White Paper that is true. Admittedly the White Paper was fairly broad. We do not claim to know what they were really thinking about. I do not think the people who wrote it really have gone that far, themselves. Under the White Paper, as we read it and the only way we can read it we would not earn any more depletion in the Iron Ore Company of Canada.

Senator Phillips (Rigaud): I suppose you will agree it is probably called the White Paper because those who read it blanched at it.

Mr. Fairley: I can assure you we did, Senator Phillips.

Senator Phillips (Rigaud): Let me put the second question to you, if I may. On the basis of the proposed changes in the law what is your opinion with respect to the ability to get further working capital on underwritings from the public if the White Paper in its present form were implemented.

Mr. Fairley: I think that it would make the securing of funds for the exploration and development of Canadian mineral deposits very much more difficult than it is at the present time. There are just too many other countries, as I said, that offer tax incentives which would be far superior to what Canada would be offering under the proposals of the White Paper. As we all know, capital goes where it is wanted and it stays where it is well treated.

The Chairman: I think you might add a supplement to that, that minerals occur regardless of the nationality of the country.

Mr. Fairley: That is certainly true.

Senator Phillips (Rigaud): Mr. Fairley, I am sure I speak for all honourable senators in that we regard you as a very serious person and your company as a very serious company. When you say financing will be made much more difficult does that mean it will simply involve a greater effort to get the money or inability to get the money if implemention of the White Paper goes through?

Mr. Fairley: I think it would result in inability to get the money in many cases.

Senator Phillips (Rigaud): Inability.

Mr. Fairley: I would say that if someone found a mineral deposit that was so good that you could pay all the taxes and take all of the tax difficulties which you would have in Canada and still make it pay, obviously on an economically viable basis, it would go. There would be many, many mineral deposits in Canada which are now operating, which if found under the White Paper proposals would not come into existence in the first place.

Senator Phillips (Rigaud): May I put a third question and then I am finished. Has the publishing of the White Paper and the climate created resulting therefrom in your opinion retarded mineral operations in Canada in terms of the exploration and the like?

Mr. Fairley: Very much so.

The Chairman: Tell me, Mr. Fairley, is there not some plan of development by Iron Ore that is an expansion by way of pelletizing so as to make your product more competitive? Is there something that is being affected by the provisions in the White Paper?

Mr. Fairley: Yes, sir, we have in the Iron Ore Company. May I say since the inception of the development of the Iron Ore Company it has steadily grown and today it is one of the largest iron ore producing companies in the world. We have several projects in the Iron Ore Company on which we have been working for several years.

I do not want to get into too much detail on that because this is under negotiation at the moment with the Government and it would be improper and inappropriate for me to have too much to say. These projects would involve several hundreds of millions of dollars to be invested in any other country that needs to be developed, which would never be developed until we moved into it. It would give many more new jobs and develop a great deal of foreign exchange.

I can say that, generally speaking, these projects are now coming to the point of fruition.

Senator Connolly (Ottawa West): How close are they to fruition?

Mr. Fairley: I will say that under normal conditions they would be coming to fruition within months. The possibility of their going ahead will be jeopardized, if the White Paper goes into effect. If we maintain the present tax law with the present incentives the prospect of these projects going ahead will be enhanced.

Senator Beaubien: Mr. Fairley, how much a year do your operating companies pay in royalties to the province of Quebec?

Mr. Fairley: To the province of Quebec?

Senator Beaubien: Yes. You pay so much at the mill head or whatever it is.

Mr. Fairley: We would not pay as much in the province of Quebec as we do in Newfoundland or Labrador, because our operations in Labrador are many times larger than those in Quebec.

Senator Beaubien: Well, could you give me the figures for the two provinces, then?

Mr. Fairley: I am afraid we cannot answer your question exactly, Senator Beaubien, but the producing company, the iron ore company, does pay royalties to the province of Quebec. I will find that out for you and give it to you later, if I may.

Senator Beaubien: And would you find out what you pay Labrador, too, please?

Mr. Fairley: Yes.

The Chairman: Do you know what the federal taxes are that the iron ore company pays at this time?

Mr. Fairley: I must tell you, Senator Hayden, that we have avoided getting into the details of the iron ore situation because they are making their own presentation later and we would hate to interfere with their situation.

Mr. Finley: Mr. Chairman, I should like to add something further in regard to the provincial taxes. It may be an element that you are not so directly concerned with but we are very directly concerned with provincial taxes.

Being an Ontario lawyer I should like to deal with this matter on the basis of the Ontario mining tax, with which I am quite familiar. The Ontario mining tax, subject to a deduction of $50,000 on your profits, is 15 per cent. The 15 per cent is calculated on a formula that results in Ontario taxing 15 per cent on a varying figure, varying from 20 to 40 per cent more than Ottawa charges taxes on. In other words, in Ontario when they try to value the production at the pit's mouth—which is where they get at it—they allow you processing charges. They do not allow you any depletion or any exploration outside of Ontario, and they do not allow you administrative expenses, head office expenses, or trust company expenses. So, ultimately, people tell us we pay 15 per cent of our profits to Ontario, but actually we pay Ontario substantially more than 15 per cent as you in Ottawa understand 15 per cent, because in Ontario it is calculated on a much larger sum.

I believe Mr. Benson must have been misquoted in Sudbury the other night when he is reputed to have said that he is going to allow us to deduct mining taxes as an expense. We have been deducting that for 40 years. So it must have been a mistake by the newspaper.

The reason this adds so much to our burden is that it is deducted as an expense, and, if you took an ordinary company and got away from the question of write-offs and got into operation about five or six years, you would find out that the Ontario mining tax calculated on Ottawa figures, on the amount of Ottawa profits, would add about 10 per cent to our cost. Ten per cent. You see, ordinarily, you would say it is only $7\frac{1}{2}$ per cent.—half of 15 per cent, if you are taking the 50 per cent tax at Ottawa. You would say it is only costing you another $7\frac{1}{2}$ per cent because they allowed it to you as an expense, but it is costing you closer to 10 per cent because it is calculated on a much larger sum. Well, I will have to admit that it might vary as low as 8 per cent, but not any lower than that. What does that mean, if you bring the White Paper in? Just let me stop for one minute. The next thing that happens in the province of Ontario is that as of the 1st of July, 1969, there is provincial assessment of buildings, plant, machinery and equipment. For the first time in our history all our buildings, plants, machinery and equipment are being assessed for municipal purposes. In years gone by that was absorbed and the money was paid by the province to the municipalities. The result now is drastic. I cannot give you the figures, but you know as well as I do that if you have a municipal assessment on many billions of dollars in a town of 20,000 to 30,000 people you are going to have 1 per cent or 2 per cent of what your profits are...and maybe you can only guess at what your profits are.

The implementation of that tax, which is small compared to the rest the allowance of an expense which has already been allowed for 40 years; the implementation of the White Paper; all these things are going to mean that mines are going to pay a tax which will be between 58 per cent and 62 per cent, depending on the situation, and getting around to ordinary stages after you have been in opera-

tion for a few years. Admittedly that is only a guess on my part, but it is a pretty good guess. You do have write-offs, but write-offs are originally capital. So you have got us into a range of taxation which, in my estimation, puts us higher than other companies, if Mr. Benson is basing it all on 50 per cent. Actually, it is more than that; it is $51\frac{1}{2}$ per cent in Ontario and it is more than that in Quebec. But even taking the 50 per cent, in relation to any other kind of company I know of, the White Paper is going to cost us another 8 or 10 per cent more than any other company.

Senator Connolly (Ottawa West): What does that do to your competitive position?

Mr. Finley: If you place a value on mine property or, in assessing the value of mine property, my belief is that between 25 and 40 per cent of these mines will not come into production at all because you evaluate the mines on what you may get out of them, and if you find out that your tax rate puts it up $16\frac{2}{3}$ per cent, which is really what this White Paper does, if you evaluate a property on the basis of a 60 per cent tax rather than a 44 or 45 per cent tax, you are not going to get as much profit.

Senator Connolly (Ottawa West): What is the average rate in the United States?

Mr. Finley: The average rate of exemption?

Senator Connolly (Ottawa West): The average tax level. You say it is now about 45 to 50 per cent in Canada. Where is it in the United States?

Mr. Finley: It is about 48 per cent.

Mr. Fairley: It depends on the company.

Mr. Finley: I was only quoting the rates to you.

Mr. Fairley: In many cases it depends on the company and what property is like. My guess, and this would be an estimate only, because there are so many companies, my guess would be that the average mining company in the United States pays somewhere between 35 and 40 per cent in taxes, with all of its deductions.

Senator Phillips (Rigaud): Of course your dramatic indication of a possible rate of 58 per cent to 62 per cent based on the White Paper highlights the point in the White Paper that its implementation must be worked out in co-ordination and co-operation with the provinces in order to reach the figure of 50 per cent mentioned in the White Paper. Now am not quarreling with what you are saying, but it is necessary to co-operate with the provinces to make sense of some of the suggestions in the White Paper.

Mr. Finley: That is what we are saying.

Senator Connolly (Ottawa West): Following on Senator Phillips' question, if the claim is that the provinces are very badly off for income, and they undoubtedly are, it does not seem to me to be in the realm of possibility or it does not seem to be realistic to expect the provinces to forego any portion of their taxes.

The Chairman: I don't think Senator Phillips was suggesting that they would. He was making the point that the White Paper was based on the element of co-operation and co-ordination.

Senator Connolly (Ottawa West): Then coming back again, Mr. Finley, you quote the Minister, and I know the statement you mean, that he will consider a deduction for the mining tax that was paid to the province, and you say quite rightly that this has been allowed for forty years now as an expense. Perhaps what he meant to say was that they would allow a tax credit for what was paid to the provinces. Would that make much difference?

Mr. Finley: Obviously if we got a tax credit for what we pay the provinces, it would make a difference. But that is treating us like a manufacturing company, and I don't think we should be treated that way. However, if we did get that, it would bring us back to the same.

Senator Connolly (Ottawa West): Would you then need all the depletion?

Mr. Finley: I think that is Mr. Fairley's question.

Mr. Fairley: The answer is that we would, senator, because of the peculiar situation in the mining industry. When you go into the manufacturing industry, it is a much more secure industry than mining. Today, and I am sure you heard these figures before, but just to reiterate the point, mining is a high risk industry in Canada, on a strictly statistical basis. To find a new economically viable mineral deposit today costs $30 million, and this is not counting development, the costs of equipment and machinery and the opening of the

property. In our own case we started out with a $300 million investment in addition to that which has gone to double that since then. But it takes $30 million to find a viable property, and this is somewhat analogous to the company making, say, television sets, which spends $30 million to find a site for its plant. It is a ridiculous comparison, but it is somewhat equivalent. But, as I say, we must take into account that the mining industry is a high risk industry, but it is one that we do very well in Canada. It is one of the things in which we are supreme in the world and is one of the few things where we are ahead of the rest of the world. If we don't keep this position, it is just going to make investment in the mining industry in Canada less attractive and it will destroy our competitive position in the rest of the world.

Senator Cook: The iron ore industry in Labrador—there is another group there as well?

Mr. Fairley: Yes, sir, there are two others in the same area, one of them entirely in Quebec and one partially in Labrador and partially in Quebec, as we are.

Senator Cook: But the industry does now pay substantial income tax to the federal treasury and to the provincial governments?

Mr. Fairley: Yes.

Senator Cook: You say that your group spent $625 million and the other group also spent substantial amounts?

Mr. Fairley: Yes, sir, I don't know how much, but I guess between the two of them it would be about the same amount.

Senator Cook: And you say on page 21 of your brief that if the White Paper proposals had been in effect, this development would not have taken place?

Mr. Fairley: I made that categorical statement as my opinion, yes, sir. When we look back and say this might not have happened or this might have happened, then we are making an individual opinion, and that is my opinion.

Senator Cook: Therefore there is a good chance that about $1 billion would not have been invested in Labrador if the White Paper proposals had been in effect?

Mr. Fairley: Yes, sir.

Senator Cook: And there is a good chance that the many many millions of dollars now being paid by the two industries would not have been paid?

Mr. Fairley: Yes, sir.

Senator Cook: And together you started the Twin Falls development?

Mr. Fairley: Yes.

Senator Cook: And was the development of that not a great help to Brinco?

Mr. Fairley: Yes, sir.

Senator Cook: So that if that had not been developed—if the iron ore industry had not been started in Labrador, Brinco might not have been able to get going?

Mr. Fairley: Well, you are stepping a little beyond my ken, and I wouldn't want to go that far. But let me put it this way, Senator Cook, the area into which we moved was absolutely devoid of human habitation when we moved in there. There were not even Indian or Eskimo villages there. The Indians occasionally went in there to trap and came out again. The town of Sept Iles was a village of 700 people when we went there. We moved in there, and because we moved in, subsequently others moved in because we built the railroad and so forth—and here I would mention that we built almost 400 miles of railroad and another company built almost 200 miles. We have developed four or five new communities, Shefferville, Labrador City, Wabush, Gagnon and Sept Iles. Seven Islands of course has gone from a town of 800 people to something over 20,000. We now have a large development in the area as a result of this investment, and it is my opinion that if the White Paper proposals affecting the mining industry had been in effect at the time we went in there, we would not have gone.

Senator Macnaughton: What was the cost of building the railroad?

Mr. Fairley: Well, if I remember correctly, the first investment was $300 million total, and I guess maybe half of that would be for the railroad.

Senator Cook: So that it is not beyond the bounds of possibility that had the White Paper been in force at that time, Labrador today would still be a virgin wilderness?

Mr. Fairley: I think that is correct.

Senator Cook: Almost $2,000 million would not have been spent on its development and many many more millions in income taxes would not have accrued to the Canadian and provincial treasuries, quite apart from the effects on employment and the development of this area on the Canadian economy and the Canadian people?

The Chairman: I notice that in the Hollinger Report for 1969, they make provision for income tax of $4.9 million.

Senator Cook: I was thinking particularly of the income tax paid by the companies themselves.

The Chairman: No, this is just by Hollinger.

Mr. Fairley: This is just by Hollinger. I could not tell you what the total income tax by all the companies has been, but it has been substantial—put it that way.

The Chairman: Mr. Fairley, I want to ask you a question about markets. You mentioned negotiating 25-year contracts with six different United States companies. I take it those contracts are still in operation?

Mr. Fairley: They are.

The Chairman: Is there provision for escalating prices?

Mr. Fairley: Yes, there is provision, to answer your question. The prices in the contract are based on the published Lake Erie price of iron ore, which is a price which has been published for some 50 years, worked back to the shipping point, which in this case happens to be Seven Islands.

The Chairman: Is your contract drawn in such form that you are not subject to the competition that other people would be subject to in moving into, say, the U.S. market, or are you subject to the play of competition?

Mr. Fairley: Oh, we are subject to the play of competition, because it is the play of competition, for one thing, which keeps the price back. Also I might say that the pricing arrangements, which are fairly complicated in these long-term contracts, cover only the shipments of ore to those six steel companies who are equity partners and who have given the long-term contracts. We also sell a substantial amount of ore in Europe, and even in Japan now.

The Chairman: What would be your annual production? Is that an available figure, or is it one you do not wish to state?

Mr. Fairley: No, it is available. This year the Iron Ore Company is scheduled to ship, barring unforeseen difficulties, somewhere between 20 and 21 million long tons of iron ore concentrates and pellets.

The Chairman: How much of that would be covered by the six contracts you refer to?

Mr. Fairley: About 16 million tons, but we will probably never go to the full 16 million tons. I would say that the actual shipments probably will be somewhere near 15 million tons.

The Chairman: Is that 20 million you refer to capacity production at this time?

Mr. Fairley: It is approaching capacity production. Let me say this, it is capacity production at our Labrador City operations. The Schefferville operations can be expanded and contracted very quickly. If we were really put to it we might go beyond that at Schefferville, provided we could sell that kind of ore, but we just cannot. So I would say that it is approaching capacity. Also the other factor is that when you reach a certain point your railway becomes a bottleneck and you have to make capital investments such as double tracking here and there and putting in additional siding, and so forth.

The Chairman: So you have to do some arithmetic to decide whether or not you will increase production

Mr. Fairley: Yes, that is right.

The Chairman: I notice in your brief—and think it is worth mentioning—that you say that the Canadian mineral industry provides Canada with about 30 per cent of its foreign exchange.

Mr. Fairley: Yes. Just to be sure I get this on the record, when I say the Canadian mineral industry I am speaking of the mineral industry as the Dominion Bureau of Statistics speaks of it, which includes all minerals and not just metals.

Senator Hastings: Does it include oil?

Mr. Fairley: Yes, it does include oil. It includes all mineral products: fuel, coal, nonmetallic minerals such as gypsum and that kind of thing, and metals.

The Chairman: A very substantial portion of your market is outside of Canada?

Mr. Fairley: Yes, pratically all of it. We have a small Canadian market, but not much.

The Chairman: So you are earning foreign exchange?

Mr. Fairley: Almost 100 per cent of everything we produce earns foreign exchange.

Senator Connolly (Ottawa West): Is there any present threat in the White Paper proposals to those communities you described when Senator Cook was questioning you?

Mr. Fairly: I think obviously, senator, any operation which is now operating and which will continue to be economically viable will continue to run. I think the threat to those particular communities we are talking about is a threat that maybe future further developement will be hindered. Certainly, with the present set-up, as long as the money to spend is there and as long as we continue to operate it, then we will do so, but it certainly holds a threat to any further development of those communities.

The Chairman: Do you mean by way of expansion?

Mr. Fairley: By way of expansion, yes.

The Chairman: Or exploration for new resources?

Mr. Fairley: Both.

The Chairman: So really you would not have any earned depletion because you would simply be exhausting a resource which you have?

Mr. Fairley: That is right.

Senator Everett: Mr. Fairley, when the officials of the Shell Oil Company were here they proposed, as an alternative to the depletion suggestion in the White Paper, a 10 per cent gross depletion and a 10 per cent earned depletion base on a 1 for 4 basis. Could you tell me if you think that suggestion by Shell would find favour with Hollinger?

Mr. Fairley: I would like to work the figures out, since we have not considered it yet, but do you mean 10 per cent on gross income?

The Chairman: Yes.

Senator Everett: Similar to the United States system.

Mr. Fairley: Yes.

The Chairman: Gross production income.

Mr. Fairley: That in itself is pretty good, and plus the other—When you say "1 for 4," do you mean $1 depletion for $4 exploration?

The Chairman: Yes.

Senator Everett: Yes, taking into account the 1 for 3 concept of the White Paper.

Mr. Fairley: The 1 for 4 would not help us at all, as Mr. Finley points out. The 10 per cent of gross would be interesting, but I would not want to make a statement on that as an expert until I check it against our figures.

Senator Everett: I would not want to trap you, but do you think it is a suggestion that is worthy of consideration, that it is not one you would throw out altogether?

Mr. Fairley: No, I would not throw it out.

Senator Everett: You think it looks interesting?

Mr. Fairley: It would certainly be something that should be considered, and we could make a study of it to see about it.

The Chairman: Senator Everett, why do not we leave it this way with Mr. Fairley, that he will make a study on it and let us know what his view is as a result of the study?

Mr. Fairley: I will be glad to do that.

Senator Phillips (Rigaud): In writing, so it could form part of the brief by way of supplement?

The Chairman: Yes.

Mr. Fairley: We will be glad to do that.

The Chairman: Yes. As and when it comes, we will file it as part of the proceedings.

Senator Everett: As I understand it, the White Paper proposes a fast write-off. It also proposes that the earned depletion can be carried forward from year to year, although it is limited to 33⅓ per cent of the net in any one year. How attractive are those provisions of the White Paper to a company like Hollinger, leaving aside for a moment the fact the three-year exemption is to be removed

and the depletion is to be placed on an earned basis?

Mr. Fairley: Neither of those proposals is attractive to us at all. As I pointed out in my statement this morning, this fast write-off obviously has some value—I would not say it did not—because it does allow you to get your money back quicker than you would otherwise. But we get it all back now; we get all this write-off now, plus the three years. The only thing now is that we get our write-off over a longer period of time, but we get it back.

Senator Everett: You get it back presumably on a diminishing balance basis?

Mr. Fairley: Well, which ever way you care to choose, that is right.

Senator Everett: You would get it all back, but it would be over a longer period of time?

Mr. Fairley: Yes, a longer period of time.

Senator Everett: So this would be on the basis of as quickly as you can take it?

Mr. Fairley: It is not necessarily a long period. It depends on what you can work out with the tax department as the length of the operation of your property. It could be a short period. If you have a property that is going to work out in six or seven years then it would be quite short. It is something which is a little better than the present depreciation set-up, but it really does not give us anything more. We get it back anyway, plus the three years, so it is not giving us any extra.

Senator Everett: Let us assume for a moment the department decides to give a mine the fast write-off, but the depletion was on the present basis of $33\frac{1}{3}$ per cent for the net, with no carry-over. Under those circumstances—and please correct me if I am wrong—you could not claim any depletion during the fast write-off period if the write-off was sufficient to use up all of your profits, whereas under the earned system you can claim the depletion and if you cannot use it you can carry it forward as a credit against future income?

Mr. Fairley: This may be, but, senator, the depletion under the White Paper is so small as to be almost insignificant. In Hollinger's case it would be only about ten percent of what it is now, so it is so small as to be almost insignificant.

Senator Everett: Ten per cent of what?

Mr. Fairley: Of our present depletion.

Senator Everett: Ten per cent of your present depletion?

Mr. Fairley: Yes.

Senator Everett: In Schedule 1 you have prepared a comparative analysis between an extracting company and an ordinary company.

Mr. Fairley: Yes.

Senator Everett: You provide a situation here in which I gather there is no continuing exploration?

Mr. Fairley: I am sorry, but I missed that one, sir.

Senator Everett: I am referring to Schedule 1 which is entitled: "Comparative analysis: Extracting Company Vs. Ordinary Company".

Mr. Fairley: That is right.

Senator Everett: Do you not provide a situation here in which there is no continuing exploration?

Mr. John P. Kinghorn, Auditor: That is right.

Mr. Fairley: I will ask Mr. Kinghorn to speak to that because he developed these things.

Mr. Kinghorn: Well, we just picked a fairly easy example. If we had put in the future exploration we would have had to carry the schedule on *ad infinitum*, and we would not know where to stop.

Mr. Fairley: Furthermore, if you had additional exploration costs in here the profit figure at the bottom would be quite different. It would be a whole lot less because your exploration costs come right out of your income in one way or another. What we have done here is to assume that you have a mineral property that runs for 20 years, and we have compared it with a manufacturing company—admittedly a stylized one—and we put the same amount of money into both of them. At the end of twenty years the stockholder has got about the same amount of tax money back from both of them under the White Paper, but in the case of the manufacturing company there is still a viable operation which is able to continue. There is still a

major asset, whereas the mining operator has nothing but scrap equipment.

Mr. Finley: I would like to say that this computation does not include provincial taxes, which makes a very substantial difference to a mining operation. A mining operation would show a very different aspect in relation to a manufacturing operation, if the figures included the provincial mining taxes.

Mr. Fairley: Yes, and we stated that in the explanation of this. The reason why we did not put it in is because we are handling this purely at the federal level, and provincial taxes vary. So, we just did not put them in.

The Chairman: What would be your estimate of the percentage of change if you had reflected provincial taxes?

Mr. Fairley: It would be about 10 per cent less.

Mr. Kinghorn: What we did here was to assume an operating profit after provincial taxes. They are taken off the operating profits. Of course, that would depend upon which province you were in.

Senator Everett: The provincial taxes are deducted from your income?

Mr. Fairley: No, they are not deducted here.

Senator Everett: I thought Mr. Kinghorn said that he had taken them off.

Mr. Kinghorn: Yes, they are. We are assuming that they were deducted from the operating profit.

Mr. Fairley: You have assumed an operating profit after the deduction of the tax?

Mr. Kinghorn: Yes.

Mr. Finley: The distinction I was speaking about was not one of deducting them as an expense, but of deducting them as a tax credit. That is where the whole difference comes in.

Senator Everett: What you are talking about in your shareholder's account at the bottom is what happens when you deal with the shareholder?

Mr. Kinghorn: There is no flow-through of depletion under the White Paper. When it comes to considering the shareholder, presumably the shareholder is going to get his money, and he has to pay his full rate of tax on that portion that is not covered by the present rate of tax.

Senator Everett: Yes, I think we understand that. In your financial report for the year ended December 31 you show provincial income taxes paid by Hollinger Mines Limited of $3,958,000. Can you tell me whether you paid any federal income tax in that year?

The Chairman: No, this is provision for taxes.

Mr. Fairley: Yes, that is the federal tax.

Senator Everett: Was that payable or was that deferred? I do not have your financial statement here.

Mr. Fairley: It is payable, yes.

Mr. Hunt: That is the federal tax payable, yes. It is currently payable.

Senator Everett: In the second paragraph on page 15 of the brief, Mr. Fairley, you make the statement:

> With few exceptions, every mineral produced in Canada could be replaced today on international markets by minerals from other countries.

Mr. Fairley: Yes, sir.

Senator Everett: I assume that one of the exceptions is nickel.

Mr. Fairley: That would be one of the exceptions.

Senator Everett: Would you care to enlarge on that statement for us.

Mr. Fairley: Yes, I would be glad to. Nickel is one exception. As you know, Canada is a major source in the free world of nickel. To a lesser extent, asbestos is one of them. We are not the largest producer of asbestos in the world, but we are a major producer. If there was no asbestos from Canada then other sources would have to be developed, but there is no reason why this cannot be done because there are other asbestos deposits in the world.

This is something that the International Nickel Company can tell you about, but as we go into the future nickel production in Canada will become a less and less proportion of the total world's supply, because right now there are tremendous nickel developments going in in many other places in the world. The International Nickel Company could give you the figures quite accurately.

Anything else that is of significance in Canada can be produced, and is produced, at other places. Certainly, iron ore has been, for the last 15 years, extremely competitive. This can be proven by the fact that up until this year, when there was a very small increase in the price of iron ore in the United States, iron ore was selling for about ten per cent less than what it was selling for twelve years ago. There are not many other items in respect of which that is the case.

Every other thing produced in Canada can be produced at other places equally cheaply, and in many cases they can be produced for less money than they can be produced in Canada. We are a big copper producer, but 25 per cent of the world's supply of copper is produced in the United States, and we know that a lot is produced in Chile and Zambia, and other places too.

The Chairman: May I interrupt you for a moment to read an excerpt from a speech made by Sir Val Duncan, who is the Chairman of Rio Tinto-Zinc Corporation and Rio Algom Mines Limited, which is a uranium mining company. One sentence in his speech strikes me as being your view. He said:

> There is, in my view, no country in the world whose single mineral resources are so vital to world industry that they could not, in due course, be replaced from somewhere else on this planet.

Mr. Fairley: I would subscribe to that completely.

The Chairman: And he also said:

> Capital will flow in the future, as it has in the past, to those countries where it can get the best return.

Mr. Fairley: Yes, I will subscribe to that too.

The Chairman: Are there any other questions?

Mr. Kinghorn: Referring back to the provision for income taxes of $3.9 million at the year end, as shown on the balance sheet, I would point out that there was only $770,000 of that unpaid.

Senator Everett: Those were deferred taxes, I assume?

Mr. Kinghorn: No, $770,000 would be the amount due in the next month.

Senator Everett: Have you no deferred tax account?

Mr. Fairley: No.

Senator Burchill: I am interested in the statement you made that the price of iron ore last year was only ten per cent above what it was ten years ago.

Mr. Fairley: No, sir, it is still below what it was ten years ago. What I said was that until the slight rise this year it was ten per cent lower than it was twelve years ago.

Senator Burchill: How can you contribute, make the machine go with the increased costs of ten years to carry today?

Mr. Fairley: It is a tremendous question and, of course, the answer is this...

Mr. Finley: Depletion.

Mr. Fairley: Mr. Finley has given a very good answer. There are a number of factors. In the first place, there are many iron ore companies that did not go; they just closed down and could not make it. However, the ones that are going have managed to do so because, we hope, they are well managed. They have made constant improvements in their technology and productivity through the use of bigger and bigger equipment and machines, lots of capital investment, and have been continually able to increase the production. The Iron Ore Company has steadily increased production ever since we started.

Senator Everett: At the top of page 19 of your brief, you say that:

> In the absence of favourable circumstances in Canada, and being no less astute than people abroad, Canadian investors would divert mining funds to enterprises in other countries offering more incentives and more opportunities.
>
> The authors of the White Paper apparently anticipated this possibility and proposed tax measures which can be interpreted as a deterrent to such a development.

I find that very difficult to accept and I wonder if you do also?

Mr. Finley: I think you have a good point. It does deter foreign investment. The only way that can be overcome is to obtain, or have a foreign income, which cannot be done. You would have to have a foreign income to obtain your write-off, because this White Paper is a funny animal, if you will excuse the expression. It seems to stop Canadians,

but it does not do too much to the investor coming in, except the lack of returns on his money, which is enough. However, in answer to your question, until you do get foreign capital, foreign exploration would be deterred under this White Paper.

Senator Beaubien: In other words, you could not deduct your foreign exploration from your Canadian income?

Mr. Finley: That is right.

Senator Molson: Just for our own committee and record, I think that it is worth while emphasizing the point brought out by Senator Cooks' questions. We are discussing the Hollinger brief and in doing so tend to think of the problems of a mine. We are really discussing the problems of an enormous area which, as has been stated, went from bush to country that is...

The Chairman: Productive.

Senator Molson: Very productive and now highly populated. It has hundreds and hundreds of millions of dollars of investment.

I was in Seven Islands 40 years ago, when the greatest feature, apart from the harbour, was the unbelievable noise made by the sleigh dogs howling at night. To think of that development from the tiny village that has gone on in the whole empire that now depends on it, Port Cartier and others, is really difficult to grasp. However, the importance of this brief is not the problem of one mine, but that of this vast and new, heavily populated area.

The Chairman: In other words you are saying that we should personalize this in terms of what has happened in the area and the improvement by reason of the development there providing employment, locating people, establishing industry, and producing substantial income, a hundred per cent of which is in foreign exchange.

Senator Beaubien: Tremendous tax revenues for the two provinces and the federal Government.

The Chairman: One element which we have not directly mentioned is that in everything that has been provided in the development of that area you have provided additional purchasing power which did not exist before, through the people employed and the businesses there, et cetera. When that is totalled, there is a tremendous additional benefit to Canada.

Senator Molson: It is on a scale that we cannot really visualize. It must be seen to be believed.

Senator Cook: And not a cent of Government money has been spent there; it is all private capital.

Senator Macnaughton: In other words, a dramatic contribution by industry.

The Chairman: That is correct, an industry that was prepared to move out and investors who were prepared to risk capital. This has happened because the climate was right.

Mr. Fairley, I want to thank you and your colleagues very much.

The Chairman: The next submission we have is from Syncrude Canada Limited. Mr. Thorsteinsson, the Tax Adviser, is going to make the presentation. With him is Mr. Spragins, President and General Manager.

Mr. P. N. Thorsteinsson, Tax Adviser, Syncrude Canada Limited: Thank you, Mr. Chairman and honourable senators. First I must say a word of appreciation for this opportunity of attending at this committee to make our views known. We have what we believe to be a unique situation which relates to a unique resource in Canada. My comments are intended to apply to the resource, which is the Athabasca tar sands, rather than our own particular concern in the development of it. I have been advised that I may proceed on the assumption that the brief has been read. However, in order to put the comments that Mr. Spragins and I would like to make additionally into perspective, if you will bear with me I will read the summary by way of introduction.

The Athabasca tar sands in northern Alberta contain over 286 billion barrels of recoverable reserves of synthetic crude oil equivalent, which is of the same order of magnitude as those of the famed Middle East, or about 28 times the total amount of remaining proved recoverable reserves of conventional oil in Canada. The tar sands are unlike any other resource in Canada and for years have resisted numerous attempts to extract the oil economically from the sand.

Contained in the brief is a description of the tar sands in terms of granules of sand wrapped in a layer of water and a layer of oil. Reference is made to the extraction problem, which has thus far resisted profitable, economic attempts to extract oil from the sand.

The demand for oil in the U.S.A. is expected to outstrip domestic, that is domestic U.S. supply, supply (including Alaska) by approximately 4.5 million barrels per day by 1975 and by 6 million barrels per day by 1980. Those figures are confirmed by a National Energy Board of Canada from which we took some of our approximations. Canada has an excellent chance to supply a greater part of this market by developing the Athabascca tar sands.

Our concern is that if we do not move now with the lead time necessary to develop projects of this magnitude, we will lose our chance to move into supplying that market. There are competitive domestic sources in the United States quite capable of supplying that vast demand when the Americans complete the development of projects they have under way now to produce synthetic crude from oil and from oil shales. The competitive sources of supply that otherwise can move into and pre-empt this market of the late 'seventies are set out in some detail in Appendix 6 of our brief. We are saying here we have a chance to go now and we are a little bit ahead in our technology.

Syncrude has developed a process through the pilot plant stage and proposes an immense project to cost over $200 million to produce oil from the sands. This is a high risk undertaking involving new technology and costs must be such as to permit the end products to compete in the established market for petroleum. The proposed investment is marginal under the most realistic assumptions and the operating risk factor is sufficiently large that despite the approximately $30 million spent to date to develop the process, a final decision to proceed with the basic plant investment will not be made for a further three years, depending upon the assessment at that time of a number of variables, which I will deal with later. Syncrude has a permit from the Alberta Oil and Gas Conservation Board to start production but not before 1976. That, of course, is the provision intended to protect conventional production as it exists now in Alberta.

The risk factors to which I referred are best attested by the absence of any line up of competing potential suitors for the development of this resource. If I may turn here very briefly to page 10 of the main part of our submission. We point out at the bottom of the page, in paragraph (e)

> Aside from tax considerations the technical risks facing the developer remain large and to an extent unknown:
>
> Item—Previous government and private process attempts prior to GCOS—

which refers to Great Canadian Oil Sands Limited, a company that has a plant operating in the tar sands today—

> as outlined in Appendix I, have all been unsuccessful.
>
> Item—The only plant actually extracting oil from the sands has operated at a loss since inception in September, 1967.

I think it is fair to say they have had a lot of operating difficulties:

> This reflects the difficulty in the implementation of efficient operations in extremely large plants.
>
> Item—Syncrude has a process different from that of the plant just referred to. Its results have been encouraging at the pilot plant stage, but no full scale plant has in fact yet operated anywhere employing Syncrude's proposed process.
>
> Item—The only other two companies (Shell Canada Limited, and Amoco Canada Petroleum Company Ltd.)—

which used to be called Pan American—

> to show serious interest in the development of the tar sands in recent years have respectively abandoned and deferred their permit applications before the Oil and Gas Conservation Board.

There are no other potential suitors at the moment to move into and develop the Athabaska tar sands resource.

To return to the summary, we say in paragraph 4 that the elimination of the three-year mining tax exemption—and in a moment Mr. Spragins will develop the concept that we are essentially a mining operation—and the drastic reduction of the depletion allowance proposed in the White Paper will almost certainly kill the project. I will have to comment later on exactly what we mean when we say "will almost certainly kill the project". The White Paper proposes sharply reduced fiscal incentives to the Canadian oil industry without differentiating between conventional and synthetic crude production, by which I mean the tar sands. Conventional means the stand-

ard oil in which you drill in the ground and the liquid hydro-carbons and gas flow. There is no differentiation between the conventional production in that sense and synthetic crude production from the tar sands, which is the unique resource we have up in Northwestern Canada.

Senator Connolly (Ottawa West): At the beginning you suggest it is imperative that development proceed with the tar sands because of developments that will occur for the production of synthetic crude somewhere else and in another form.

Mr. Thorsteinsson: Yes, sir.

Senator Connolly (Ottawa West): You call this one synthetic crude, do you?

Mr. Thorsteinsson: Yes.

Senator Connolly (Ottawa West): What do you mean by the other type of synthetic crude that might replace it?

The Chairman: He called it shale.

Mr. Thorsteinsson: In the Western United States there are vast quantities of oil locked into deep deposits of shale rock. Out of that rock comes a material that is able to be manufactured into synthetic crude. The oil shale of Colorado, as it is called, and the process of liquifaction of coal—and there is an infinite quantity of oil underlying the Eastern United States—are the two sources from which synthetic crude can be produced, and will be produced to supply this market demand that we foresee for many years down the road unless Athabaska gets in there and pre-empts the market to a certain extent.

Senator Connolly (Ottawa West): You are actually working with oil, even though it is a grain of sand covered with a layer of water and a layer of oil; it is the oil you want to get?

Mr. Thorsteinsson: Yes. In the other case it is the end product of a process which changes one substance, say coal, into another, or the shale. It is somewhat similar to the sands. It is a question of cost. We believe we are ahead in economics and the technology. I am looking at paragraph 5 on page 2 of the summary:

> The White Paper proposes sharply reduced fiscal incentives to the Canadian oil industry without differentiating between conventional and synthetic crude production (tar sands). By contrast, the U.S. Government in 1969 increased the depletion allowance available to taxpayers producing synthetic crude by mining oil shale while at the same time reducing the depletion allowances available for all conventional oil operations.

Senator Phillips (Rigaud): Would you develop that by telling us what amount of increase.

Mr. Thorsteinsson: Yes, I can, Senator Phillips. In appendix IV of the brief there is a little note on the United States Tax Reform Bill of 1969. It says:

> Prior to the enactment of the Tax Reform Bill of 1969 the Internal Revenue Service took the position that oil shale was subject to percentage depletion at the rate of 15 per cent of gross income, subject to a limitation of 50 per cent of the net income from the property. Gross income was computed on the value of the crushed rock after it had been removed from the earth, brought to a central point and crushed. The Tax Reform Bill of 1969 changed the point of depletion to the value of the kerogen extracted from the shale after the shale had been extracted from the earth, brought to the central point, and crushed and processed in the retort and the waste shale disposed of. The net effect of this change in definition regarding mined oil shale is to increase the allowable depletion by approximately 100 per cent.

The effect is that they move the point in the process more toward market and therefore there is more value of income later on with respect of what you have in the allowance.

The Chairman: I suppose it became more of crude oil.

Mr. Thorsteinsson: Yes. It continues:

> The amount of the increase would depend upon the particular operation involved as to the relationship of the value of the crushed rock and the value of the kerogen after the retort operation.
>
> This increase in the allowable depletion in the case of mined oil shale was enacted in the Tax Reform Bill which reduced the depletion for oil and gas from 27.5 per cent to 22 per cent of gross income (not to exceed 50 per cent of the net income from the property).

Senator Phillips (Rigaud): I do not want to divert you from the presentation, but in rela-

tionship in Canada have you produced a schedule or suggestion as to what should be done here or are you simply giving this to us as a guide as to what we may consider?

Mr. Thorsteinsson: I am giving you that as a guide and also to point out the significance of this raise that I referred to a moment ago.

Senator Phillips (Rigaud): Have you given us an alternative approach in Canada to that which is applicable to conventional oil extraction?

Mr. Thorsteinsson: No sir. Our submission in connection with the White Paper is very simply that Athabasca needs to be exempted from the proposal to abolish the three-year mining exemption and to change the present percentage depletion allowance. We are talking in terms of exempting the resource.

The Chairman: What you are saying is that it would be a feasible operation but if there was no change in the existing tax holiday and the existing depletion...

Mr. Thorsteinsson: That is right.

The Chairman: ...I take it you would prefer to have the depletion capital laid on the gross production income other than on the net?

Mr. Thorsteinsson: That is obvious. I would say that we want to make it very clear. In the debate that goes on about the White Paper it is very easy for taxpayers, who are being asked to pay increased taxes, to get themselves into the position of appearing to be asking for favours. Let us be clear about this. We are here making a submission, the effect of which is to say do not increase our taxes. We are not here asking for any handouts or breaks.

We have, in good faith, made economic projections involved in a project which has cost so far $30 million based on the present ground rules. We are here to oppose the change.

Senator Phillips (Rigaud): I did not want to get you off the track. I wanted to get the ultimate objective.

Senator Everett: While we are on that point I wonder if I could ask whether you know why the United States Government gave such a low depletion to shale recovery prior to the enactment of the Tax Reform Bill? I understand it was 15 per cent in relation to 27 per cent.

Mr. Thorsteinsson: It was roughly in line with the different other kinds of depletion rates that apply to different kinds of mining operations in the United States. As we heard earlier this morning, United States percentage depletion varies with the type of resource. Oil depletion for many years was 27½ and the Government reacted to the view that it should be reduced, that is to say with respect to conventional oil production. The 15 per cent, and correct me if I am wrong, was in line with other kinds of mining depletion rates that would go for other different kinds of things.

Senator Burchill: On page 5 you say that you cannot commence production under your permit until 1976. Why is that?

Mr. Thornsteinsson: We must have the permit granted by the Alberta Oil and Gas Conservation Board in order to do any hydrocarbon extraction in the province of Alberta. It contains a condition that we do not go into production until 1976. I think that is because the present short-run situation of oversupply that exists in Alberta with respect to conventional production concerns the Alberta Oil and Gas Conservation Board. In effect they are saying that it is a good idea to develop Athabasca, but that they do not want us coming on strong in the next few years and usurping markets—conventional oil. If I may presume to know what they are thinking, it is said our projections after 1975 will be a substantial shortfall in supply and there will be a market we can move into.

Mr. F. K. Spragins, President and General Manager, Syncrude Canada Limited: I might say that three and a half years construction is scheduled in order to get this eventual commitment date. We back up to 1973, which is 3½ years from 1976. We try to compress construction into as short a time as possible because of the interest on investment.

Mr. Thorsteinsson: To proceed with the summary on paragraph 6:

> If this project goes ahead, Canada will gain by:
>
> (a) The local economic benefits in an improverished remote area of a $200 million oil plant, together with a $50 million—$100 million electrical utility development.

The Chairman: Could you stop there for a moment. Arising out of Senator Molson's statement, when you talk about this impover-

ished remote area are you in a position to give us a little description of that area.

Mr. Spragins: Eastern Alberta is the area in which the present federal Government is undertaking a fairly substantial program to educate and improve the educational standards. This area includes both eastern Alberta, which is about 200 miles long by about 150 miles wide and it contains a population of approximately 14,000 people. The majority of these people other than those located in the actual communities are virtually all on welfare. This is the area where we propose to put our development.

At the present time, other than the one plant, there is no activity in this area. There are no farmers either, but there is some industrial development.

The training which is done by the federal Government or anyone else is not much help to these people unless there is some industry established there to assist in supporting them.

Senator Phillips (Rigaud): What do you border there?

Mr. Spragins: Northwest Territories and Saskatchewan on the east side.

Mr. Thorsteinsson: The second net gain we see Canada achieving if the project goes ahead is a favourable continuing impact on the regional economy. The Syncrude project alone will create 6,000 or 8,000 jobs in Alberta when the plant is in operation.

The third point is that the taxation, which refers to the present rules, the $33\frac{1}{3}$ per cent taxation of a new source of income better benefits the Treasury than 50 per cent taxation of nothing. There will be tax revenues that will be generated indirectly from employment and services for the construction and operation of the plant, and there are going to be royalty revenues to the province of Alberta. Finally, we envisage other tar sands plants and satellite industries that will follow Syncrude's success.

We in Syncrude envisage this, senator, but we seem to be the only ones who have a project of what seriously will take hold and go. However, we expect that if we go and successfully operate others will follow, because we are nowhere near tapping the full resource. If it starts too much to come in right away others will follow if our process is successful and is done on a viable basis. There is indeed that kind of follow-through.

Syncrude Canada Limited submits that the public interest in the development of the Athabasca resource requires retention of the three-year mining exemption and present depletion allowance, not alone for Syncrude but for the development of the Athabasca tar sands. If the present law regarding the three-year mining exemption and percentage depletion allowance is to be changed for conventional mining and oil operation, an exception should be made for processes producing oil from the Athabasca tar sands, which, as noted, is a resource unlike anything else in Canada.

Now, honourable senators, the position is that while we do not disavow the representations and views of the conventional mining and oil industry, we simply say that that is not our concern today. Whatever may be decided to be done about the conventional industry, here is a unique resources circumstance, and no one can say the two are quite the same. The exception should be made not just for us but for the resource.

Perhaps Mr. Spragins will amplify what I have said concerning the operation itself.

Mr. Spragins: Honourable senators, I think, because the product we produce is oil, that the Syncrude project has been often categorized by people in the public as a petroleum venture. But this is far from the case. Actually, it is an open pit mine. We expect to be removing between 125,000 and 150,000 cubic yards of ore per day when this plant is in full operation. We have the same types of problems as any other mine would have. We have problems concerning ore dressing and all of the things that are strictly related to the mining industry and not to the petroleum industry.

Mr. Thorsteinsson: An aspect of the fact that we have a mining operation that produces oil gives rise to a comment that I think is appropriate. We really have the worst of both worlds. Perhaps you will appreciate that the price of crude oil has not changed for 20 years and, essentially, we look at selling into a market where there is a fixed price level. The conventional well, of course, once established, is able to run with very little in the way of operating costs. Once it is set up and flowing it is able to sell into a market with a fixed price without too much concern with the inflationary expense of marketing costs, because the labour component or labour intensity is very small once you are on stream.

In a mining industry you have inflationary effects on operating costs because it is a labour intensity type of operation. Here we have the disadvantage that because we are a mining operation we are subject to those cost pressures. With the sole possible analogous example of the gold industry, we are the only people with the problem of rising costs pushing up against a fixed price for the product. The conventional industry in the oil business sells into the fixed-price market, of course, but it is not bothered by the cost push so much. The conventional mining industry suffers increasing costs, but historically, with the exception of the gold industry, has been able to increase prices to take care of the upward pressure of costs.

That gives us the worst of both worlds, which is another part of the risk factor of the difficulty we have in going ahead with this project. I think it would be appropriate now if Mr. Spragins were to say a word to you about the financial data.

Mr. Spragins: If I may say a word about the company itself first, Syncrude is what we call a cost company. It is a managing-operator type of company. It is owned 100 per cent by the four participating companies: Imperial Oil, Atlantic Richfield, Cities Services and Gulf Oil. These companies own all of the assets involving the equipment as well as the reserve of oil bodies. Each company looks at this as an individual owner and, when and if we ever get into production, each company will take that product in kind. In other words, we will deliver the oil to the plant gate and each participating company will take charge of its own product and sell it.

Therefore, the type of financial analysis that Syncrude itself can give to the White Paper is not very meaningful. To get deeply involved in the financial aspects of this project in so far as the participants are concerned is difficult. In fact, Syncrude basically does not have the data. These companies deal at arm's length; primarily, I think, because they are concerned with anti-trust laws in the United States and combines laws in Canada. Therefore, a meaningful analysis of the White Paper effects is most difficult. We have discussed this problem with Mr. Benson. He appreciates the problem we are up against. He has accepted our apology for not including financial analysis in our brief but he has also suggested, and we have agreed, that we should provide some backup financial analysis to the Department of Finance.

Senator Connolly (Ottawa West): After you have done that, perhaps you could give us the same information.

Mr. Thorsteinsson: The difficulty, senator, is that this is a joint venture among four companies and the effect on each of them is different because of their other situations with respect to drilling and exploration costs and depletion and other income from other sources and so on. We are saying here that we, as Syncrude, are not able to give you any meaningful numbers and, therefore, do not want to get into projecting alternative arithmetic cases. But we are going to do that with the Department of Finance in confidence. Our difficulty is that we have to get into what is internal profit ratio information of the participants in order to have a meaningful discussion of that, and we thought that would not be appropriate information to have on public record. We must ask you to take on faith for the moment our proposition that we have a marginal project to look at at best under the present rules, and this increase in taxation is virtually going to kill it subject to what I am going to say in a moment with respect to what I mean by that phrase.

At the moment we are accepting the invitation from the honourable Mr. Benson to go to the Department of Finance and talk specific numbers in confidence by way of buttressing our points.

The Chairman: Who will be the vendors?

Mr. Thorsteinsson: The four companies. It is a joint venture in the normal sense, and each company will take its own oil and sell it.

Our permit requires this oil to be exported, I might add. It is not going to move into Canadian markets at all. It will be set up for export.

The Chairman: Syncrude Canada Limited is just a management company. Is that right?

Mr. Thorsteinsson: It is.

The Chairman: Syncrude Canada Limited is just a management company, is it not?

Mr. Thorsteinsson: Yes, it is.

The Chairman: It will manage the operation?

Mr. Thorsteinsson: Yes, sir.

The Chairman: And what revenues is it likely to have? Only the management fee?

Mr. Thorsteinsson: Syncrude as such will not show a net profit. When we talk about the revenue flows, they will come to the four companies. They are the participants in the joint venture, and they will realize the sales proceeds right through.

Senator Beaubien: How will they get delivery of the oil? By pipeline?

Mr. Spragins: There is a pipeline already in existence from the tar sands which connects with the Interprovincial and it will be delivered by pipeline.

Senator Beaubien: So there is no problem there?

Mr. Spragins: There is no problem there.

The Chairman: Now, on the movement of the oil to, say Gulf who have a 10 per cent interest, it must move into export. What does Canada get out of that?

Mr. Thorsteinsson: Canada gets the benefit of increased tax revenue from Gulf which is a Canadian tax-paying organization.

The Chairman: That would also apply to Imperial?

Mr. Thorsteinsson: Yes, sir.

The Chairman: And what about Cities Service?

Mr. Thorsteinsson: Cities Service and Atlantic are still so far as I know in a net loss position in Canada. That is to say they spend a great deal more money on exploration in Canada than they have yet realized out of production. The income flows to those two companies will, of course, grow as all other Canadian income will grow to work against their existing drilling and exploration credits. This will put them along the road to further taxability faster barring further exploration and drilling expenditures.

The Chairman: The real tangible development would be the development of the area and the industry that would go in there and the provision of more employment and the increased purchasing power.

Mr. Thorsteinsson: And a very substantial effect in the long run on tax revenues. This would involve several governments, the federal Government, Ontario and Alberta.

Senator Phillips (Rigaud): I am finding it difficult to follow this one. If Syncrude is purely the agent for the four participating companies, does this brief suggest that in respect of Syncrude production, the four constituent companies, shall we say, get their special depletion rates? That is as distinguished from what other rates may be applicable to their other activities?

Mr. Thorsteinsson: Yes, sir.

Senator Phillips (Rigaud): In other words, in effect what you are asking is that the four participating companies, that is to say Gulf, Imperial, Atlantic and Cities Services do get the benefits of the present law in respect of the Athabasca sands production.

Mr. Thorsteinsson: Yes, sir, and anybody else who produces the Athabasca tar sands.

Senator Phillips (Rigaud): Yes. In effect, you are acting more or less as a management agent?

Mr. Thorsteinsson: Yes, sir.

Senator Phillips (Rigaud): And you are stating the case for the four constituent companies in respect to their activities. You are not relating it to your own income flow.

Mr. Thorsteinsson: Oh, no, not at all. We will never have any net profit. The company itself is set up to make no profit or loss.

Senator Burchill: This project was conceived under the present tax act.

Mr. Thorsteinsson: Yes, sir.

Senator Burchill: Are you satisfied that you can proceed under the present set-up?

Mr. Thorsteinsson: Well, no. We say that at the present time we look marginal and we are proceeding. The final decision to go or not to go will not be taken until 1973, because that is when we must start construction and make our contract commitments on the plant, depending on the assessment at that time of numerous variables of which, in fairness, the tax climate is only one. Now we are not in a position to say that we are definitely going to go ahead or that we are not going to go ahead because there are too many variables left. Now, you appreciate that $30 million has been spent, which is a pretty good piece of earnest money in terms of the desire to go ahead with the project, but if the price of crude declined substantially, that obviously would affect it.

The Chairman: But is it not Syncrude that is asking that the present law be maintained?

Mr. Thorsteinsson: Syncrude on behalf of its four participants, sir.

The Chairman: It must be the four participants.

Mr. Thorsteinsson: Yes, sir.

The Chairman: And you are satisfied that these four participants in the form in which they exist now would qualify for the tax holiday and the depletion allowance?

Mr. Thorsteinsson: Yes.

Senator Connolly (Ottawa West): May I follow with a question dealing with what Senator Phillips asked a few moments ago. Assuming for the sake of argument that your project is found to be viable and you can go ahead in 1973, in the light of the size of the deposits and the extent of the deposits in the tar sands, how many other projects of the same size as yours could be started?

Mr. Spragins: You mean immediately?

Senator Connolly (Ottawa West): At any time.

The Chairman: I think what Senator Connolly means is the area avilable for exploitation.

Mr. Spragins: I think without any additional exploration, the prospective sites have been isolated which would support about 10 new plants. This would not be the end of it because it is a highly prospective area. In addition to these locations that have been isolated, I am sure there are many others that would support many other plants. If you look at the area that is suitable for mining, and suitable for mining under the present technology, there is a total of 86 billion barrels of synthetic crude reserve available tc us. And I think as time goes on and as our technology improves, we will be able to recover eventually most of this oil. This 86 billion barrels is about twice the reserve of the United States at the present time.

Senator Phillips (Rigaud): Do I take it that the request you are making for the maintenance of the present law does not limit itself, in your opinion, to an area, because it would be an unusual thing in a tax statute to have a reference to an area and to have an area described as the area which produces oil from the Athabasca tar sands. I take it that what you have in mind is that the maintenance of the present rate should apply to the production of crude oil which can be described as being produced according to a certain definition.

Mr. Thorsteinsson: That will be perfectly satisfactory as an alternative. With respect, senator, there are provisions in the Income Tax Act that go by area. You have the area incentive extra depreciation situation where there is a reference to plants built in a given area and you have an accelerated write-off.

Senator Phillips (Rigaud): I find it difficult, and I am sure all honourable senators will so find when we come to prepare a report. On the assumption that you make your case that the Athabasca tar sands are entitled to special consideration, surely it would not be difficult to formulate a recommendation that relates itself not to an area but rather to the type of operation.

Mr. Thorsteinsson: I would agree with that suggestion, sir. We simply thought in terms of the area, because if you define synthetic crude production from tar sands deposits, with a couple of exceptions, you are practically saying Athabasca. But there are some exceptions.

Senator Phillips (Rigaud): Mr. Chairman, if I might put it this way; could you file with us as a supplement to your brief a description of what is known as Syncrude oil or oil that is produced by the process you have in mind.

Mr. Thorsteinsson: With a view to defining the kind of production we are talking about?

Senator Phillips (Rigaud): Yes. Rather than the area covered.

Mr. Thorsteinsson: Yes. We could certainly do that.

Senator Phillips (Rigaud): Otherwise the committee will find it difficult to formulate a recommendation.

The Chairman: Unless we did it on the basis of geography.

Senator Phillips (Rigaud): Yes, and I for one, Mr. Chairman, would find it difficult to develop such an approach.

Mr. Thorsteinsson: I would accept that suggestion because it is simply a question of defining a production and letting it happen where it may.

Senator Phillips (Rigaud): I for one feel, having heard the witness, that it would be

most helpful if you gave us a supplement to your brief giving a description of the type of production in respect of which you think it is desirable to retain the present law.

Senator Connolly (Ottawa West): Just keep in mind, I would suggest, that we should distinguish between this process and the process you described whereby in the United States they are extracting oil from shale and from coal deposits too. Shale I think is closer to this method than the coal system.

Mr. Thorsteinsson: I think so, but we could distinguish between our product and other kinds of synthetic crude on a technical basis, I think.

Senator Connolly (Ottawa West): Because of the social implications here, I just ask you this question. These deposits are fairly far north, and I know that the snow situation is not as serious up there as it is in some parts of Canada farther south, but you are going to do an open-pit operation, you say. Is that contemplated to be a year-round operation?

Mr. Spragins: Yes, we have conducted a pilot test on a sizeable pit, 600 feet long, 300 feet wide and about 80 feet deep. To get some experience of the weather conditions we opened it, allowed it to freeze to 40 below for three weeks, and re-opened the pit and continued mining tarsands.

I think a better example is the Great Canadian experience where they have been able to operate through the winter now for over three years.

Senator Everett: Mr. Thorsteinsson, you state on page 3 of your brief, in the last paragraph:

> Canadian crude oil prices on the other hand have been virtually constant for the past 20 years which forces Syncrude to proceed on the assumption that the price for its products cannot be increased.

Certainly, looking at the past that is a valid assumption, but looking also at your statement that you expect there will be a short fall of requirements of North American crude, do you say, in your judgment, that is a fact?

Mr. Thorsteinsson: Yes, and I was coming to that point and I will be glad to deal with it now.

The fact is that the U.S. domestic price of crude oil is inelastic and it does not respond to the normal concepts of supply and demand. The essential reason for this is that there are virtually unlimited quantities of crude oil available from the Mid-East at prices way below the normal prevailing U.S. crude oil price.

To give you the point in contrast, U.S. crude currently runs around $3.30 a barrel. You can unload Mid-East crude at any seaport in the United States for about $2 a barrel. The whole problem of how much of that off-shore foreign crude should be allowed into the United States is the subject of a constant push-pull phenomenon involving the Government of the United States and, of course, the domestic producers and the consuming interests.

The point is that because of the threat of this cheap foreign oil, that but for tariff and quota restrictions could be allowed in to flood the market at prices well below the present established price, the threat of the import of that foreign off-shore oil serves to maintain the domestic price at a level above which it will not rise.

I am confident in stating that the best view in the industry and, indeed, in government circles in the United States—and I here refer to the recent task force study that was appointed under presidential commission for the United States Government—is that the future price of crude for the period we are concerned with—I suppose the next 10 or 15 years—will remain static or, if anything, tend downward.

You have also the problem that foreign crude is not only available—and this is commented on at some length in this U.S. task force study, of which I have some copies, if anyone is interested in following up the matter, the diversity of the producing nations and the ones that have come on stream recently—I think there is a comment in there that there are now about 13 excess supply crude exporting countries, whereas a few years ago there were only four or five. Their diversity and their political history would not lead one to think that they will in any way organize themselves into a cartel in order to endeavour to enforce price rises, so that the suppliers who have excess capacity are scrambling to supply what markets are available, and the only thing that keeps that cheap foreign crude out of the United States is governmental policies with restrictions, and there have been quotas. The presidential task force which is now being much debated in the United States, recommends a tariff system instead of quotas. But, in any event, the pros-

pect is for flat or downtrending domestic crude prices, and that is the basis of our forward assumption wherein we say we have no prospect of a price rise to bail us out of whatever marginal economic difficulties we are in.

Senator Phillips (Rigaud): Would you support that statement by giving us the names of some of the companies that have come in on stream?

Mr. Thorsteinsson: Yes, I can, sir. I have a note here.

Senator Phillips (Rigaud): Just give us a summary, some idea of the world pressure on crude products.

Mr. Thorsteinsson: I would like to find my note if I may, because there is a complete note on it here, if I may just take a second.

This is a quotation from this rather fat book put out by the U.S. Government called, "'The Oil Import Question," which is a report of the presidential task force on the relationship of oil imports to the national security.

Senate Phillips, may I interrupt myself for a moment to complete the answer in this direction? You appreciate that the reason the American Government has continued its restrictions on off-shore foreign oil is a concern with national security, and they obviously have a concern about getting unduly dependent on foreign off-shore like Middle-East crude, because of the threat of interruption in relation to national security. That is why in Canada we have enjoyed quotas that have enabled our oil to move to their market, and that is why we expect—that is the Syncrude participants—to be able to move Athabaska crude into the market that I spoke of at the outset, within the framework of the foreign crude sitting there, if you will, as a threat that keeps the price down, but one that really, in the end, is not going to be brought in to flood the local market because the American Government simply does not want to get that dependent on interruptible off-shore foreign sources, and the whole question is very much bound up with concerns about national security, so far as the Americans are concerned.

To get back to what Senator Phillips asked—this is taken from page 214 of the work I mentioned—in 1956 there were four major oil exporters. Today there are at least potentially eleven and the number is growing, extending from the Arab and non-Arab countries of the Middle East through North Africa and West Africa to the Caribbean and on to Indonesia. The potential eleven are Algeria, Canada—this, of course, is written from the U.S. point of view—Indonesia, Iraq, Iran, Kuwait, Libya, Nigeria, Saudi-Arabia, Trucial States and Venezuela.

Senator Phillips (Rigaud): To tidy up the point, for the assistance of our adviser, would you identify the task force study by date?

Mr. Thorsteinsson: I will. In fact, I will give Mr. Gilmour a copy of that. I think that is the best idea.

Senator Everett: Can you tell me whether the earned depletion concept as contemplated by the White Paper is of any value whatever to Syncrude?

Mr. Thorsteinsson: Absolutely none, because we have no exploration, as such, to do. Let me say in further amplification to that answer, as we say somewhere in our brief, we are not here concerned with the conceptual adequacy of theories of earned or unearned, or whatever it is, depletion. We are simply looking at the question whether this project goes or not and it has a good chance of going if the present ground rules are left alone, but not if the tax bite is changed adversely against us.

Senator Everett: I think we have to be a little more conceptual than you do.

Mr. Thorsteinsson: Quite so.

Senator Everett: Just carrying on from there, in light of your answer to the last question, if the proposal was to eliminate the three-year tax-free period and to substitute therefor a fast write-off with a carry forward provision, and to have a gross depletion of, say, 20 per cent, what would Syncrude's position be then? Would that make Syncrude feasible?

Mr. Thorsteinsson: I thought about that just a little when you asked the same question of the Hollinger people. We also have not done any figuring on that basis, but I would think that 20 per cent gross depletion would be a very substantial compensation. You are thinking, in other words, of something like the U.S. system. I can only say that we have not done any calculations. Have you any thoughts on this, Mr. Spragins?

Mr. Spragins: I think the principle is something which we would like to look at, but as

to the calculation itself, we just have not done it.

Mr. Thorsteinsson: We might undertake to do that and come back to you on it, as was done in the last case.

Senator Everett: We would appreciate that, and we would appreciate also your looking at the Shell concept, which is, of course, an alternative, at the same time, but I do not think the Shell idea would work for you.

Mr. Thorsteinsson: No, it is keyed too much to the exploration dollar. We have a problem that is shared only by Hollinger and the Labrador Iron Ore people in that the deposit has been there for years and everybody knows where it is. There is no exploration as such for us to do. So any kind of tax abatement which relates to the exploration activity is of no concern to us.

Senator Everett: Are you going to be able to take advantage of the three-year tax-free period?

Mr. Thorsteinsson: Yes.

Senator Everett: If you had a fast write-off, would it improve your situation at all?

Mr. Thorsteinsson: We think that under the White Paper—we do not really know this, but I think we assume that our capital costs would qualify for a fast write-off. In other words, the $200 million we are going to put into the plant would qualify, we think, to set up the 133 per cent allowance. Our calculations indicate that that alternative does not come near compensating for the loss of the three-year mining exemption in the case at least of the two Canadian participants.

The significance, you appreciate, of the three-year exemption is out of proportion to what it might seem because it is a question of today's dollars versus future dollars. The three-year exemption operates to enable dollars to be realized net of tax out of the project early, and those dollars just loom larger in your calculations of your evenual contract return than dollars that you get later by way of depreciation or some other route.

In general, we found on the calculations we did that the value of the three-year exemption accounts for something over about a third of the difference that happens to us under the White Paper, and the depreciation allowance is somewhat less than two-thirds. That is the way in which it works out.

I should like to say a word, if I may, about what we mean by the phrase "virtually kill". We have said in our brief that the proposed increase in tax levied by the White Paper proposals in the two areas with which we are concerned will virtually kill our project. That phrase was the subject of a certain amount of discussion and consideration on the part of our participants.

I, as an advocate, of course, would like to be able to come to you and say: "If these two proposals go through, we are dead", but my principals say: "No, it is not quite fair to say that. We are virtually dead, but we cannot say that this factor alone, of all the other variables that we have to worry about, will of itself put paid to the project." In other words, it would be less than honest to come to you and say that this one change puts us out of business.

This is due to the fact that as is now known, we have until 1973 in relation to our permit production commencement to go before we make our final decision whether to go or not to go in terms of letting contracts and committing substantial dollar expenditures.

There are other variables that will affect us and which will be looked at in 1973 when we take a look at the proceedings. There is, of course, the price of crude oil. If there is anything in the projection that shows a downward trend then that will obviously have a very material effect. There is the problem of the operating expense price squeeze, and the degree of operating cost estimations three years from now as opposed to today. There are the problems of mechanical operating risks, that have already been well demonstrated by the experience of Great Canadian Oil Sands. There are difficulties in the variations in the feed stock. We are doing constant testing of the sands in which we propose to operate. I might digress here for just a second to say that the tar sands are not homogeneous; there are substantial variations in the chemical composition, and in the hardness of the material, and there are variations throughout in the degree of thickness of the overburden, and there are all sorts of factors affecting the profitability of a given operation. These are details that are mentioned in our brief, of course.

We will probably run into problems concerning market restrictions. We may have a bigger or smaller market depending upon governmental action as the picture emerges in 1973. We have the difficulty of the inflationary effect on plant costs in the first place

which, of course, are compounded by delays in that area. The longer we wait then the more we have to revise our estimates of what we think it will cost to put the physical plant in place.

Offsetting that is the marginal factor of future economies of scale, and I would like to ask Mr. Spragins to talk about what the eventual hope is, and the reasons why the participants are interested in going ahead with the project.

Mr. Spragins: I think that this question has come up before. This is one operation that we are really looking at. I think we have to go into this thing with the concept that there are other things to come. We are looking down the road to the point where we will have not one plant but several plants. At that time I think we would have to assume that it is going to be successful, and if that is so it means that we will be able to reduce the cost of production. It is this long-range projection that we are looking at in respect of getting this first plant going. In the first plant we expect to work out the engineering details that will enable us to develop an economic and viable resource. So, it is this prospect of the potential of things to come that keeps our interest alive in this program.

Senator Phillips (Rigaud): Before the constituent companies are to get the relief that you are asking for, would they not have to operate through wholly-owned subsidiaries?

The Chairman: That was the import of the question I asked Mr. Thorsteinsson a few minutes ago. I asked him if he was satisfied that they could qualify.

Mr. Thorsteinsson: Yes. Perhaps I misunderstood your question, Mr. Chairman. I think all four of the companies qualify in the sense that they have the requisite principal business, and all that sort of thing. The compartmentalization of the income from this source will have to be effected by some means. I have no quarrel with that at all. It will either be done by just earmarking it, or compartmentalizing it, or running it through a separate vehicle, but those are mechanics that remain to be worked out.

Senator Phillips (Rigaud): In making recommendations we have to consider mechanics to ensure that we do not make recommendations that will create problems.

Mr. Thorsteinsson: Since we are coming back we might submit some supplementary ideas on mechanics.

Senator Phillips (Rigaud): Yes, I think that that would be helpful.

Mr. Thorsteinsson: This has been very valuable to us because we had thought that the easiest way politically, if you will, to do something about this was to say: "Well, there is a unique resource. The national interest is in accord with its being developed. Therefore, we will stake out an exemption from the new rules for that resource." As you say, that seems to have some difficulties, and we will be glad to pursue it further with you.

Mr. Spragins: We also stated that the concept upon which the project is set up is approved by the Alberta Oil and Gas Conservation Board, which made the stipulation that we sell our synthetic crude outside of Canada. Therefore, all that we will produce from this project will be sold to refineries in the United States, but we are not excluded, according to our permit, from selling our synthetic crude in other countries besides the United States. The real thing is that we do not allow the synthetic crude to be sold in Canada where it would detrimentally affect the conventional oil industry. So, the stipulation is that we go beyond the reach of the conventional industry for the sale of our oil.

This is something that we think we can accomplish in today's competitive oil picture. It has also the advantage to Canada that all of the oil we sell outside of Canada improves our balance of payments position.

Mr. Thorsteinsson: I think the point that we seek to make with you gentlemen, is that we have here an opportunity to develop a resource that unfortunately requires the length of lead time that has been mentioned in terms of constructing the plant. You do not just decide to do something about Athabaska in six months, and with the lead time that we are in the middle of at the moment Canada has here an opportunity to develop a long term resource and move it to a foreseeable and predictable market, but not without competitive pressures from alternative domestic sources of supply. We think that we are here looking at one of the most exciting, interesting, and complicated, and, if you will, imaginative resource development projects that this country has seen in many a year. As I have mentioned before, we are not concerned with the conceptual appropriateness or otherwise of the theory of earned depletion, but whether this project goes ahead and Canada moves that ore to market.

Senator Gelinas: You mentioned you have already invested $30 million in the project.

Mr. Thorsteinsson: Yes sir.

Senator Gelinas: How do you think you will invest between now and 1973?

Mr. Spragins: At the present time we are spending at the rate of about $1,250,000 per year on research and engineering development. This will continue. We have a staff of 60 people, basically research scientists and engineers, working on this project. We are very reluctant to lose this trained staff, which has been built up over the past ten years. So long as we feel there is any hope we will not disband them and will carry on with this expense.

Senator Gelinas: Is the plant in operation now?

Mr. Spragins: We have two pilot plants, one in the area of the Athabasca tar sands capable of producing about 50 barrels of oil per hour. There is another, smaller plant at our research laboratory in Edmonton. The large plant is not operating, but the smaller one in Edmonton is processing about one barrel per hour.

Senator Phillips (Rigaud): I take it that this brief represents the views of the constituent companies represented by Syncrude Canada Limited?

Mr. Spragins: Yes sir.

Senator Phillips (Rigaud): The brief does not merely contain the views of your company?

Mr. Spragins: No. You will appreciate the difficulty we encountered in reaching the views of all four.

The Athabasca tar sands project will, basically, produce oil. However, in the mining concept that we have planned we will recover ore, which is basically an oil saturated sand. This will be conveyed to a plant for slurrying. Under ordinary circumstances there are a number of products in the tar sands which are far beyond economic reach of any mining operation. I refer to such minerals as titanium, zirconium, hafnium, iron, vanadium, nickel. These are all present in great quantity, but not in very high concentrations. Once we mine this material, which is supported by the oil part of our product, we have these other minerals in slurry form ready at the pit in flowing streams. At this point it is very easy to concentrate them. We feel that the by-product potential is very great. We are not referring to a few bucketsful of metal, even though the concentration in the deposit may be a very small fraction of one per cent. When we refer to zirconium we mean amounts which can be recovered to equal the production of all other mines in Canada today. Our problem with the potential is not one of how much we can produce, but how much the world can absorb. These products are vast and a long way down the road, but still potential. We have to consider them as possible recoveries which would be very valuable to Canada.

The sand itself is a good glass sand, which is relatively scarce in Canada. The glass sand production in Canada annually is a few hundred thousand tons. We would introduce over 100,000 tons per day, so you can see the quantity problem. Even though there would be an immediate market for a little sand it would not be much to offset the cost of a $300 million plant. However, this development would give rise to local employment. Silver is a by-product.

We should mention petrochemicals. The oil from the Athabasca tar sands is highly aromatic, which means that it forms a great building block for plastics. It has been said that it is a waste of Athabasca crude to use it as fuel, because it is so suitable for these building blocks for plastics. Fortunately, the Athabasca tar sands is big enough to supply both markets, so there is no concern there.

There has been some mention of the power facilities that will be installed with the plant. This power plant will not only produce the power for our plant itself, but through the availability of cheap residual fuel it will be able to manufacture export power which will be fed into the Alberta grid system. This will necessitate the construction of a 250-mile power line to tie in this Athabasca source of power with the Alberta grid. There is a potential of export power of about 300 megawatts from our initial plant. A Canadian utility company has expressed interest in developing the power plant for our needs and a portion of the requirements of the Province of Alberta. It is very likely that they will construct this plant and carry the power to the Alberta grid, so that the by-product from our plant will flow into useful energy.

Senator Molson: I suppose these minerals are in various kinds of combinations through the sands?

Mr. Spragins: Yes.

Senator Molson: And the minerals you have just mentioned are relatively valuable.

Mr. Spragins: I only mentioned a very few examples of what is there. At the present time this is an active part of our research program. Unfortunately I cannot go much further in describing the by-products process, because our patent position is not yet very secure.

Senator Phillips (Rigaud): If you can give me another 25 years to see all this I will recommend your view.

The Chairman: Honourable senators, we now come to the Canadian Potash Producers Association. Mr. Hurdle, would you introduce your panel and then make your opening statement?

Mr. B. E. Hurdle, President, Canadian Potash Producers Association: I have with me Mr. Vic Wansbrough, Managing Director of our Canadian Producers Association; Mr. Ken Cork, Vice-President and Treasurer, of Noranda Mines; Mr. Ralph Holzkaenper, Managing Director, of the Potash Company of Canada; Mr. B. Carlson, who is Vice-President and Comptroller, of International Minerals and Chemical Company who operate in Saskatchewan.

Our Canadian Potash Producers Association appreciates the opportunity of being able to present its views on the federal Government's White Paper on Taxation to the Standing Senate Committee on Banking, Trade and Commerce. With your permission, I do not propose to read our brief on the White Paper, but would like to offer some explanation of the workings of the potash industry and relate them to some of the points brought out in the brief.

Five of the eight potash mines which started operations within the last two years, and one is not yet started, so it is impossible to collect good statistical information for the industry as a whole. In the event of any questions, some of the members of the delegation have had long association with the potash industry and should be able to provide the answers.

Potash is not a material of common usage and a brief word of explanation might be in order. The term potash is generally used to cover several salts of the element potassium, the commonest of which is potassium chloride. Potassium chloride is a minor constituent of sea water, and under favourable climatic conditions in the past shallow seas have evaporated leaving potash-rich residues. When these were buried by later deposition of other minerals, and thus protected from the weather, they became the potash bearing strata that are mined today, like underground coal mining. In one case in Canada potash is mined by dissolving and bringing the potash to surface in a water solution. Elsewhere, potash is recovered from brine lakes such as the Dead Sea, Great Salt Lake and Searles Lake in California.

Potash as mined is mixed with clays and other salts, the most common being halite or common table salt. Separation of commercial potash involves a complicated separation process. Plants for this purpose are expensive, so the capital investment in the potash business is high. I have here a sample of Canadian potash and the refined product, if anyone would like to see it. Of all potash produced about 95 per cent is used as a fertilizer. Along with nitrogen and phosphorous it constitutes one of the three main plant foods. Potash was first mined in Germany in 1860, and its value as a plant food was recognized at this time. However, use as fertilizer underwent slow steady growth until the mid-1940s. Since that time the growth has accelerated as world population and food requirements escalated.

Potash in economic concentrations is available in a number of countries. The most important are Russia, Canada, France, East and West Germany, United States, Spain, The Congo, Israel and Italy. There are other areas such as England, which is planning two new mines, and Ethiopia, Libya and Peru which have mineral deposits.

While potash is an important fertilizer, comparatively little is used in Canada, since Western Canadian soils are still naturally rich in potash. Soils that have been cultivated for a long period become deficient in potash, and certain crops, the most notable of which is corn, need large amounts of this key plant food.

Canadian potash production is wholly centred in the Province of Saskatchewan, and is almost entirely exported. It is an important segment of Saskatchewan's economy, and has become increasingly so since the competitive position of Canadian wheat has declined in world markets. Over a period of a little more than ten years, more than $700 million has been invested in plants and equipment for Saskatchewan potash. In excess of 3,500 permanent new jobs have been provided to

people who live in some 20 towns or cities in the province, and from studies elsewhere in the mining industry this should leave to five times this employment, or 17,000 jobs in Canada. This would mean about $30 million annually paid in wages by direct employment, and five times this amount, or $150 million, for secondary employment. Annual expenditures on services, supplies and equipment are estimated at $20 million. Federal, provincial and municipal taxes total about $8 million, not including personal income tax, which we estimate might be $5 million.

Certainly it is an important industry to Saskatchewan and to Canada, and it should be kept healthy. Because of a chain of circumstances, there has been an over-competitive position develop in world potash and a serious decline in prices has taken place over a period of two or three years. The industry has been going through a very difficult time. However, there is every indication that conditions will gradually improve.

The industry objects to several points in the White Paper on Taxation. In the first place, large capital expenditures as noted above were undertaken on the basis of certain taxation conditions. The first of these was the three-year tax exempt period. Some potash producers were able to take some advantage of this, but the new producers have not made any profit to be exempted. Thus while the argument is academic at present for potash producers, this was a tax incentive that attracted capital into the mining industry, and if it is the intention to maintain a heallhy mining industry this incentive should be maintained.

The second item, depletion allowance, also constitutes a tax condition that companies used in making the decision to invest in the potash industry. Depletion allowance must carry through to shareholders, whether corporate or individual, in order for this tax situation to continue. We recognize that provision has been made in the White Paper for an allowance based on exploration, but this has no meaning for potash mines. Once exploration has been completed and an ore body put into production and the ore development expenditure has been made for the foreseeable future there will be little or not expenditure on exploration or equipment for many many years to come. Potash deposits, like iron and coal, and like the syncrude product we just heard about, are big and must have a long life to support the tremendous initial capital expenditures.

The Chairman: What you are saying is that earned depletion in those circumstances is more or less meaningless.

Mr. Hurdle: That is correct. To have such important ground rules in taxation changed after large capital sums have been invested would constitute, in our opinion, a lack of good faith that can only jeopardize future investment in the Canadian economy.

In addition to the effect that the removal of the three year tax exemption and the removal of the depletion allowance would have on attracting investment in the Canadian potash industry, there are important competitive market considerations. Obviously the proposed tax reforms would increase the industry's costs in a highly competitive world market. This is of crucial concern.

The major market for Canadian potash is in the north-central United States. Here it must sell in competition with potash from south-west United States. There is also a market in eastern United States but here the Canadian product must compete with European potash as well as domestic producers. A second large market for Canadian potash is in the Pacific Rim countries of Japan, Korea, Taiwan, The Phillipines, Malaysia, Indonesia, New Zealand, Australia, India and Pakistan. These countries also buy from Russia, France, East and West Germany, Israel and the United States. Thus, despite the fact that Canadian potash has an advantage because its deposits are higher grade and hence cheaper to produce, it is obvious that in many areas this advantage is more than offset by our distance from the market.

There are other factors which enter into the competitive picture. For example, in the huge central United States market region there is a large area where freight rates from Saskatchewan and New Mexico are the same. Canada has the advantage of higher grade but most New Mexico plants have been written off and have no debt load to consider. In addition, the United States producers have a substantial depletion allowance that further enhances their competitive position. Even with present Canadian tax laws the United States depletion allowance is greater than in Canada.

For instance a tax calculation made by the largest potash company, and based on the 1970-71 fertilizer year forecasts, shows an income tax of $2.12 per ton of potash under existing rates, $3.11 per ton under the proposed White Paper tax rates, as compared

with $1.66 per ton if the same operation were in the United States. The corresponding income tax rates in Canada are 35 per cent at present, 51 per cent under the proposed rates, compared to 27 per cent in the United States. Other potash companies have much lower volume, down to one-third of the above company, and hence profits per ton and taxes would generally be less, but the tax rates are the same and the effect on the companies is even greater. Certainly it illustrates the worsening competitive position with the United States, and the handicap in international marketing.

In essence, gentlemen, our concern, and it is a very real concern, is that if the proposals for tax reform become law in their present form, the Canadian potash industry will have its competitive position seriously impaired.

The Chairman: To sum it up, it would appear that the operating potash mines have run out of their tax holiday. Mainly, and certainly in earned depletion basis proposed in the White Paper it would be of no value to them because more of your income would be taxed. This is how you get this increase of tax as a result of the White Paper.

Mr. Hurdle: The three original producers have run out of the tax exempt period. The five new producers that have just come in do have the tax exemptions, but under the present marketing conditions and price range there is no profit to exempt them to. This time it is a meaningless situation.

Senator Molson: What is the capacity at present of the total Saskatchewan producers?

Mr. Hurdle: The productive capacity is just under eleven million tons of product per year. Sylvite Mine will be coming in at the end of 1970 and at that time the total productive capacity will be in the order of twelve million tons of product per year.

Senator Molson: There are no others coming in?

Mr. Hurdle: That is all that is projected at the present time.

Senator Beaubien: How much is Canada producing a year?

Mr. Hurdle: The figure has been escalating. At the present time it is about five million tons of product a year.

Senator Beaubien: You are able to sell that now?

Mr. Hurdle: That is fairly close. It is difficult to sell the five million tons, but that is what the industry is trying to do at the present time.

The Chairman: Is that mainly export?

Mr. Hurdle: Except for about 300,000 tons of product used in Canada the rest is export.

The Chairman: This is all sold as potash? There is no by-product of this industry?

Mr. Hurdle: There are no by-products.

Senator Molson: What is the current price?

Mr. Hurdle: The current price has been set by the floor price of the Saskatchewan government. In Canadian dollars this is about $20 per ton. There are some other grades that command some premium, but the average price would be approximately $22 per ton.

The Chairman: Is this interfering with your export trade?

Mr. Hurdle: Yes. The situation is rather involved at the present time, because of the pro-rationing that has come into effect, upsetting some normal patterns. The degree of upset is difficult to state.

Senator Beaubien: When you were going into this five years ago what was the price at that time?

Mr. Hurdle: When we made a decision to go into the business it was $26.50 U.S. per ton, F.O.B. the mine.

Senator Beaubien: Now it is set at $20?

Mr. Hurdle: Approximately $20. The other factor I should mention is that when most of us went into production we were anticipating perhaps 75 or 80 per cent production of our capacity. The last allocation by the Saskatchewan government, which was based on their best forecasts regarding markets was $52\frac{1}{2}$ per cent capacity.

Senator Burchill: I suppose the cost of your production depends entirely on the volume.

Mr. Hurdle: The volume has a very large effect on the cost.

Senator Burchill: On your cost of production?

Mr. Hurdle: Yes, on the cost of production.

The Chairman: It would look like a problem of how to survive right now.

Mr. Hurdle: I think that is a correct statement.

The Chairman: It would look also that there might not be very many gains in which to apply the depletion allowance.

Mr Hurdle: That is correct. Hopefully down the road the people who put in the capital investment would like to get some return on the money.

The Chairman: You are looking for a better future.

Senator Beaubien: Before the Saskatchewan government put a minimum price on it, what had the price gone down to?

Mr. Hurdle: It has varied greatly from place to place. If I had to try and pick an average price I would say $12 to $13.

Mr. B. Carlson, Vice-President and Comptroller, Canadian Potash Producers Association: Twelve dollars U.S. is a good number.

Mr. E. K. Cork, Vice-President and Treasurer, Canadian Potash Producers Association: The price fell in half in the last five years up to say last fall. With the institution of the Saskatchewan government's prorationing and minimum price there has obviously been an improvement in price, but market effects of that are confused.

Senator Beaubien: Because of the increase in price, has volume gone down?

Mr. Hurdle: I don't think it has made any significant difference. It has gone down a small amount, but it is not significant.

Mr. Cork: There are a number of new mines and the large production capacity was available a year ago. But these things, even though they are once started, take time to work up to capacity. The effect of prorationing has been to increase considerably the rate of tonnage in other parts of the world.

Senator Molson: Does this mean that the United States continental producers are going full blast?

Mr. Hurdle: They have been operating at 90 per cent capacity and have continued to operate at that capacity.

Senator Everett: May I ask Mr. Hurdle whether, in discussing this matter of the three-year exemption, he believes that it ought to be limited to recovery of the exploration and development expenses?

The Chairman: You mean what we call pre-production expenses?

Senator Everett: Yes. In other words, the profits. The production would be equal to the profits shown sufficient to cover their developmental and exploration expenses.

Mr. Hurdle: I am in a position of representing the Canadian Potash Producers Association, which is comprised of 11 members. It is very difficult for me to make an off-the-cuff answer to that question.

Mr. Cork: I think the case of potash is perhaps a very good example of an industry where the margin of profit is small and the capital cost is very large. Certainly, in terms of today's conditions, if a new mine were to be started now I don't think there is any way in the three-year period that you would return all of your capital cost. So that suggested limitation would not apply.

However, it is possible to go a step further and argue that on the grounds both of equity and of stimulating investment in Canada, the tax-free period might be extended. That is, you are allowed three years or however long it takes to return your original capital cost. I realize this is not what my company suggested in January. It is a variation.

Senator Everett: What did your company suggest in January?

Mr. Cork: Noranda Mines suggested that, if it is necessary at all to limit the tax-free period, one way to do it would be to limit it to the return of the original capital cost. Now I am going on a step from that and saying that, if you accept that thought, maybe the next step, very logically, is to say we should forget about the three years as an arbitrary length of time and have the first return of capital entirely tax free. Then you start off fresh with write-off policies and so on. Certainly, in the case of potash this would be much more advantageous because of the very narrow profit margin prevailing in the industry.

Senator Everett: Under your proposed scheme you would then write off your development expenses twice?

Mr. Cork: In effect I am talking about double write-offs—the first time at 100 per cent rate and the second time either at the present rates or at the rates in the White Paper or whatever the proposed rates will be.

Senator Everett: I have put this question to others; that is why I ask it of you: with the fast write-off and the lost carry-forward, is there a trade-off in your mind between the three-year exemption and a gross depletion?

Mr. Cork: Again, in current circumstances, because the profit margin is relatively low, gross depletion would be quite advantageous to the potash industry. We have never thought in terms of it being a trade-off. We have never seriously considered gross depletion because it had not previously been very much suggested in Canada. But it is an interesting line of approach. However, one of your earlier questions this morning to another group, to the effect that you would have some gross depletion and some earned depletion, would have no bearing for potash because obviously there is no exploration.

Senator Everett: We understand that that would not apply to your particular case in point. Dealing with gross depletion for the moment, do you think there is a justification, if a gross depletion system were introduced into Canada, for limiting it to a percentage of net depletion?

Mr. Cork: We have that in the American system in effect when they limit it to half the total profit.

Senator Everett: That is right.

Mr. Cork: There was, I am told, an active suggestion which did not quite get through—it almost got through in the recent tax revision—to limit it to 70 per cent of net profit rather than only half. This would have meant that in reducing the gross depletion rate in most cases from 15 to 14 per cent there would have been a slight reduction in the benefit given to a very profitable mine, but in mines that were rather marginal there would have been an increase in the benefit. If the net profit is low compared to the selling price, the 50 per cent rule now holds them down in some marginal cases, perhaps. The 70 per cent rule would help. So I think things of that kind should be considered.

Senator Everett: In your case the net maximum would hurt you because of your low profitability.

The Chairman: That is what they have now.

Mr. Hurdle: It would still be greater than the present Canadian depletion of 33⅓ per cent.

Mr. Cork: What rate were you thinking of?

Senator Everett: I was talking generalities. I agree that if the rate were 50 per cent there would be an increase over what you are enjoying today.

Mr. Cork: If you took 20 per cent, as you used earlier off-the-cuff, that would be $6 a ton in effect and that certainly would be more than half the current profit margin per ton.

Senator Everett: Just coming back, then, is there a trade-off so far as the association is concerned? Do they feel a gross depletion system would be an improvement on the three-year exemption?

Mr. Cork: I think I have to answer that in a slightly larger context. First of all, I don't believe the association has considered it in that form. Secondly, the reason the association has taken the stand it has presented is that all of the companies involved made their investments—large investments—on the existing rules, and they are prepared to live by that deal. But they are very unhappy at having the rules worsened. I think that the mining industry and potash industry in particular could well have considered ways in which the existing treatment could have been improved. I think there are a number of places where one could turn to that study in the interests of encouraging mining in Canada generally and potash in paraticular. But this has not been done by the industry because, by and large, they are willing to take their lumps. They, in effect, made a deal that they would come into the industry on this basis, knowing that the Government does not guarantee the tax treatment, but nevertheless anticipating that it would continue. And the Government has proposed in its White Paper perhaps worsening the treatment. So the mining industry's position has been rather defensive. We have been rather defensive, perhaps unnecessarily so, and perhaps we should have given more thought to ways in which it could be improved, but by and large in the Association this has not happened.

The Chairman: No, but if you look at the White Paper proposals as being a new method in dealing with the mining industry, then, since it only called a proposal, maybe that should have been righted by some proposals from the industry.

Mr. R. Holzkaenper, Managing Director, Canadian Potash Producers Association: May I say a word on that, Mr. Chairman? In the

last 10 or 12 years there has been much more talk about depletion of gross profit through the activities of the oil companies in this country, which of course mostly have American backgrounds. And over the years I have noticed that there has been some difference of form or beneficial form of depletion between the mining companies on the one hand and the oil companies on the other. I think, if I might suggest it, a good deal of light will be thrown on the subject when an organization like the Mining Association of Canada comes before you.

The Chairman: They are coming.

Mr. Holzkaenper: They are coming. One thing I would like to add, if I may, is about the three-year tax exempt periods, although we have made it clear that it is of no interest or benefit to the potash companies. It has been discussed with every witness before you this morning, but one point has not been made, and I think it is a very important point. It is assumed that the White Paper proposals are giving a fast write-off on all capital expenditures. That is not so, It may have already been drawn to your attention, but there are many capital expenditures that certain mining companies have such as roads and docks and all kinds of things that are not provided for at all under the White Paper proposals. I think you will hear a great deal more about that from some mining companies. So I think this kind of section in the White Paper deserves a very close study, because it is not all plain sailing as the smooth wording might indicate.

The Chairman: Well, fast write-off is really confined to buildings.

Mr. Holzkaenper: Depreciation on that.

Senator Connolly (Ottawa West): And what you are saying is that there are other things including mines and railways and also the infrastructure and perhaps even more in connection with new towns in remote areas, perhaps sewers and water mains and perhaps even hospitals and schools and things like that.

Mr. Holzkaenper: Yes, and if I might say one other word, Mr. Chairman, and I will be very brief. I was much impressed with what happened to the previous witness who replied to the statement of Senator Molson, and what impresses me very greatly about this potash industry is that it is the only segment that I know of in the mining industry in this country where more than $700 million has been invested in a period of one decade, all concentrated in one province with all the other benefits that Mr. Hurdle has mentioned. If this is not regional development, I don't know what is, because it was just farm land before. I think it is one of the most striking examples in this country, looking at Labrador, and what may happen up in Athabasca, of what mining developments can do by way of regional development in this country.

The Chairman: And independently of government grants.

Mr. Holzkaenper: Yes.

Senator Connolly (Ottawa West): In other words, your philosophy is that through the tax incentive method you get a more efficient and a more economic and more productive operation than you do through a system of grants to assist in the development of underdeveloped areas under the public sector?

Mr. Holzkaenper: Yes, very much so.

Mr. Hurdle: It is a little more expensive in the private sector in this particular case.

Senator Connolly (Ottawa West): I think the whole concept, and we had a look at this this morning in dealing with Hollinger, had that thrust.

Senator Burchill: Mr. Hurdle, did you say you represented 11 potash producers this morning?

Mr. Hurdle: There are 11 potash producers, and I might explain that one of them has three co-owners; U.S. Borax, Texas Gulf and Swift are co-owners of one mine which they call the Allen Mine.

Senator Burchill: And did I understand you to say that the price in five years has dropped from $26.50 to $12 and some cents?

Mr. Hurdle: That is correct.

Senator Burchill: To what do you attribute that?

Mr. Hurdle: Extreme over-production and the competitive situation.

Senator Burchill: And what about consumption? How does that go along?

Mr. Hurdle: Consumption has been increasing at a fluctuating rate but for four or five years I would say it has been increasing at a

rate of about 6 per cent per year. It has not gone down; it has been increasing.

Senator Burchill: So the production has exceeded consumption. What do you see as being the outlook for the future?

Mr. Hurdle: I would expect the consumption rate to increase at about 6 per cent a year, and the total world production is approaching about 30 million tons. So, if you take 6 per cent of this, it is a fairly substantial increase. Now there are new productions coming in in other places. England is planning two new mines to come in in three or four years, and the Congo had a new mine come in in the last year, so any new consumption is not going to come completely from Canada, but Canada would certainly get its share of it over the years.

The Chairman: Any other questions?

Thank you very much, Mr. Hurdle and gentlemen.

Now, honourable senators, we will resume at 2 o'clock.

The committee adjourned until 2 p.m.

Upon resuming at 2 p.m.

The Chairman: Honourable senators, we have one brief left to consider today, that of the Bethlehem Copper Corporation Limited. Mr. Reynolds, the President, is here with some of the officials. Would you introduce your panel, please, Mr. Reynolds?

Mr. P. M. Reynolds, President and Chief Executive Officer, Bethlehem Copper Corporation Limited: Mr. Chairman and honourable senators, I would like to introduce Mr. Keith Steeves, who is Vice-President (Finance) of our company and Treasurer; Mr. John Bruk, with the legal firm of Lawrence and Shaw in Vancouver, the company's lawyer; and Mr. William Thiessen, the company's Secretary and Chief Legal Officer.

The Chairman: Are you making the initial presentation?

Mr. Reynolds: Yes, Mr. Chairman.

The Chairman: Would you proceed?

Mr. Reynolds: Honourable senators, we appreciate the opportunity to appear before your committee to supplement the brief which has been delivered to you, and to answer questions which you may wish to put to us.

In order to avoid confusion, we feel it necessary to tell you that we are a Canadian company and in no way are related to Bethlehem Steel.

Following my short introductory remarks, Mr. Steeves, the chief author of our submission, will outline the principal recommendations contained therein; and Mr. Bruk will explain the direct influence of tax incentives on the development of the mining industry and its impact on the economy of Canada.

The property which we are mining is located in Highland Valley, British Columbia. It was explored, and in 1954 it was staked by a prospector, who was grub-staked by others.

Our company was incorporated in 1955. Its success is a clear example of the effectiveness of the present tax incentives as they relate to mining.

Initial exploration was financed through the sale of shares, mainly in British Columbia. We were unable to obtain financing in Canada to complete the exploration and development of the property because proposed financiers were advised by their engineers that the property could not be mined at a profit.

The Sumitomo Metal Mining Company of Japan, very much in need of copper, in 1960 provided $350,000 to complete the exploration and to defray the cost of a feasibility study.

The feasibility study, prepared in 1961 by competent Canadian engineers, states clearly that the property could be brought into production as an economic unit only because of the assistance given through tax incentives.

We have recently applied the White Paper proposals to the feasibility calculations and without a doubt, had they been in effect in 1961-62, we would not have received the finances needed.

In 1961-62 Sumitomo provided $5,500,000 to bring the property into production at a rated capacity of 3,000 tons per day. Since that time we have retired our debt; we have increased the rated capacity from 3,000 to 14,000 tons per day; and in doing so there has been an increasing amount of foreign exchange brought into Canada through the export and sale of our product to Japan. In the seven years since 1962 this has totalled in excess of $100 million, of which $30 million was generated last year. Last year we provided $8 million in direct taxes, which is more than the $5.5 million put into plant construction in 1962.

We employ 350 people, with a payroll exceeding $3 million per year. Along with Cominco we are planning a new mine in Highland Valley to process 100,000 tons per day, at a development cost of $250 million, to employ up to 1,000 workers. The village of Ashcroft, British Columbia, has developed into a thriving community.

It is obvious that in our case the incentives have worked as incentives should: to encourage risk; to reward success; and through taxes generated the Government of Canada is reaping its reward.

Mr. K. E. Steeves, Vice-President Finance, Bethlehem Copper Corporation Limited: Mr. Chairman, honourable senators, the adoption of the White Paper Proposals for Tax Reform will result in substantial tax increases for Canadian mining companies and their shareholders. The elimination or substantial reduction of the incentives offered to the industry under the present Income Tax Act are the principal cause of this tax increase. We disagree with the statement made in the White Paper that these incentives have been "unnecessarily costly and inefficient".

Countries with whom Canada competes for mineral investment capital offer incentives to attract that capital. The incentives may take the form of reduced tax rates, depletion allowances, tax exempt income, or a combination of these.

We have recently projected the earnings of our company for 20 years, to compare the Canadian taxes with those we would pay if our mine were located in the United States or Australia. These countries were selected because they are probably our closest rivals for mineral investment capital.

Even under the present taxation system, we would pay 14 per cent less tax if our mine were located in Australia, and 20 per cent less tax if it were located in the United States.

Senator Phillips (Rigaud): Is that in your brief, Mr. Steeves?

Mr. Steeves: No, it is not.

Senator Phillips (Rigaud): I am asking the Chairman whether he would not consider it desirable to ask you to file schedules indicating how you arrive at those comparisons, to form part of your brief.

Mr. Steeves: We will be happy to.

The Chairman: Let us have them as early as you can.

Mr. Steeves: We will.

The Chairman: Thank you.

Mr. Steeves: The White Paper proposals will result in an increase of 35 per cent in the Canadian taxes payable, and we would pay 36 per cent less if our mine were located in Australia and 40 per cent less if it were located in the United States under the White Paper.

Senator Phillips (Rigaud): I would like, through the Chairman, to ask that schedules supporting that statement be also filed.

Mr. Steeves: Yes.

The Chairman: You understand that when you are asked this, you have made a study?

Mr. Steeves: Yes.

The Chairman: We would expect to get not only the conclusion but how you arrived at it.

Mr. Steeves: Right.

The growth pattern of the mineral industry in Canada has been remarkable when you consider that, even under our present system, taxation rates are not as favourable as those offered in other countries. We believe this growth can be attributed to the fact that the combination of a tax-free period and a reasonable percentage depletion allowance are attractive incentives for an industry that requires large capital outlays and extreme risks. The incentives offered in the White Paper are clearly inadequate and must result in a substantial reduction in mineral investment.

We have recommended in our submission the continuation of the tax-free period with certain limitations and changes in depletion provisions which will reduce the incentives presently offered, but in our opinion will offer sufficient encouragement to the industry to maintain its growth.

Mr. Bruk has prepared a paper that illustrates the importance of the mineral industry to the Canadian economy, which he will present when I conclude.

We believe that although some additional tax was intended, the White Paper will be much more severe to the mining industries than was contemplated when the proposals were drafted. This reflects either a lack of familiarity with the industry on the part of the authors, or a failure to evaluate the effect of certain sections of the White Paper not specifically directed at the mining industry.

To cite examples:

(1) Provincial mining taxes and royalties, which have been ignored by the White Paper, will contribute to making the tax burden of mining companies and of their shareholders greater than that of other Canadian industries, whereas under the present Income Tax Act, in recognition of the risk and wasting nature of mineral investment, mining companies and their shareholders pay slightly less tax than other Canadian industries.

Senator Phillips (Rigaud): Would you accept the view of the Hollinger company that, because of the failure to consider the royalties paid to the provincial governments, under the White Paper the effective rate would be between 58 and 62 per cent? I think you were here this morning when such evidence was given.

Mr. Steeves: Yes, we have calculated in our brief 56 per cent.

Senator Phillips (Rigaud): At 56 per cent, so you are not too far away from 58 per cent.

Mr. Steeves: Yes, that is right. In British Columbia we have a provincial mining tax based largely on the federal income tax.

Senator Phillips (Rigaud): Thank you very much.

Mr. Steeves: To cite further examples:

(2) The integration concept and the proposals to tax intercorporate dividends will both effectively eliminate the incentives that were intended to be retained.

(3) The proposals to tax proceeds on sale of mineral claims and to tax intercorporate dividends will force mining companies to revise drastically their corporate structures and the traditional arrangements for acquisition and development of mineral properties, perhaps to the jeopardy of the investing public.

(4) Limitation of the transitional provisions on depletion allowances to properties owned at November 7, 1969, may restrict the transfer of mineral properties, and in some cases production decisions.

(5) The taxation of intercorporate dividends and the integration concept will in some instances make Canadian mining companies more attractive to foreign investors than to Canadian.

(6) The proposals to tax accrued capital gains every five years may result in mining company shareholders being liable for taxes on shares that cannot be realized because they are held in escrow pursuant to Canadian Securities regulations or to sell a portion of their shareholding before mineral properties have been evaluated and the true market value established.

(7) The capital gains tax proposals may render it impossible for mining companies to temporarily transfer personnel to their foreign operations or to import consultants for their domestic operations.

(8) The proposals to disallow losses on property holdings when caused by depreciation, interest or taxes will apply to the housing projects of mining operations located in remote regions that must be operated at a loss in order to attract personnel.

(9) The taxation of foreign investment will discourage mineral development in foreign countries by Canadian companies, particularly in the developing nations who have little to gain in establishing tax treaties.

(10) The proposal to disallow creditable tax unless dividends are paid within 2½ years may render it impossible for mining companies to accumulate the large amounts of working capital required to finance new mining ventures.

Much or the future mineral development in Canada will have to be made in the northern regions where there is limited manpower, few services, severe climatic and topographic conditions and generally lower mineral grades than found in many other countries. If you add the additional taxation burdens proposed by the White Paper, the future of the Canadian mining industry appears black. The White Paper acknowledges that its proposals may reduce investments in mining. If this statement is correct, and we are convinced that it is, what other industry can be expected to continue the much needed developement of northern Canada?

In closing I would like to refer to the remarks of the Honourable Charles A. Dunning, who, as Minister of Finance in 1936, introduced the three-year tax incentive legislation. Two quotations from his address to the House of Commons seem appropriate, and they are taken from page 2336 of Volume III of *House of Commons Debates* for 1936:

> Exploration and development require expenditures of large amounts of capital over a considerable period of time. Private interprise, therefore, can only be induced to enter the field if the prizes to be gained for the relatively few successes are attractive.

And:

> I desire to add that as uncertainty of taxation is a definite deterrent to the making of new commitments in a hazardous industry, the mining industry may rely upon it that this Government will not impose discriminatory taxation with respect to mines.

I wonder how Mr. Dunning would react to today's White Paper proposals.

Senator Laird: You have spoken generally and sensibly about the mining industry, but having in mind the contribution you have obviously made to an area of British Columbia I would ask you what would happen to your company specifically if the proposals in the White Paper were implemented?

Mr. Steeves: As an operating company there would be a considerable reduction in profits by the elimination of the depletion allowance, but the more major effect, I think, would be the discouragement for future exploration in Canada.

Senator Laird: What about the matter of employment provided by your company?

Mr. Steeves: I do not think it would change because we have sufficient capacity to take care of it.

The Chairman: What about this venture that you are entering into, or that you may enter into, with Cominco to build a mill with a production capacity of about 10,000 tons a day?

Mr. Steeves: I think Mr. Reynolds could speak to that.

Mr. Reynolds: Right now there is a feasibility study being prepared by the Bechtel Company in their Montreal office. That feasibility study will be completed on about June 1, and then decisions will have to be made. Bethlehem has a 20 per cent interest in this property, and Cominco has an 80 per cent interest. This means that we have to find $50 million as our share of the total of $250 million, and we have prepared for this. We can raise the money, but when the feasibility study is received we will then have to take the mining taxation legislation as it is today, we will have to take the White Paper proposals, and we will have to see whether under the proposed legislation we will be able to go into this project and come out of it all right by paying off our investment and making some money on it.

The Chairman: You will have to assume in connection with this venture that you will not have a tax holiday.

Mr. Reynolds: Under the present rules, that is correct. We will have part of the tax holiday because if the present plans proceed we hope to have three-eighths of the plant...it is in units having a capacity of 12,500 tons a day, and it is our hope to have three of them in operation by early 1972.

The Chairman: So you would have the period from 1972 to the end of 1973, which would give you a tax holiday of a year and a half?

Mr. Reynolds: Yes. This is a very, very low-grade property. It is almost a billion tons, but it averages out at about .47 to .48 copper.

Senator Molson: I should like to ask Mr. Reynolds if he would say a little bit about his company for the record.

Mr. Reynolds: Do you want me to give its history?

Senator Molson: Yes, tell us briefly about its ownership and the amount of capitalization, and so on.

The Chairman: Yes, tell us about its location and the area it is in.

Senator Molson: There is nothing in your brief or in the summary that you gave that relates to its history.

Mr. Reynolds: Well, the property was first staked in 1898, and over a period of approximately 60 years up until 1954 it had been staked and worked on, and restaked and worked on, many times. Practically every major company in Canada either looked at it or worked on it, and walked away from it, during those 60 years. The provincial Government and the dominion Government did some work on it at around the time of the First World War, and they all thought it was uneconomic.

Three of us—myself and two friends—grubstaked Mr. Huestis who examined many properties for us in 1953 and 1954, and he recommended that this property be staked and that we look at it in a new way, by moving low-grade material in large quantities. We raised $200,000 mostly amongst our friends in Vancouver early in 1955. In September, 1955 we made a deal with American Smelting and Refining, which is one of the largest mining and smelting companies in the

world. In May of 1958 after they had expended $1.25 million they walked away saying that it was not economic. We continued to work on until 1960 when, as I told you, we made a deal with the Sumitomo Companies who now own 24½ percent of our shares.

Then in preparation for the financing which will be required in this new venture with Cominco, we sold to the Grangesberg Company of Sweden—we made the deal in November and we concluded it in January of this year—a million shares at $21 a share, which gave us $21 million.

Senator Molson: Do you know what percentage that would be of the total?

Mr. Reynolds: At that time they bought 15 per cent of our company. I understand they have gone into the market and bought some more stock. This gives us the $21 million. We have working capital of about $12 million now and we have been reasonably well assured by one of the banks that they will loan us the balance of the money if this project is feasible.

Senator Molson: The Japanese have less than 21 per cent?

Mr. Reynolds: No, they had more than 30 per cent.

Senator Molson: The Swedish interest is about 15 per cent?

Mr. Reynolds: They bought 15 per cent, but they have purchased more shares on the market. I think they are trying to get enough stock to become even with the Japanese.

Senator Molson: And the balance is in Canada?

Mr. Reynolds: It is mostly in Canada. There are a few shares in the United States and England. They are scattered around, but there are no big blocks held by anyone else.

The Chairman: What is the nature of the area of this property, and what did you do to it?

Mr. Reynolds: I first went in with Mr. Heustis in 1954 on a wagon trail about 20 miles east of Ashcroft. There was really nothing in the area except people hunting and fishing and a few cattle. The town of Ashcroft was the jumping-off place many years ago for freight to be taken into the north country. When the railway first came through it came out of Kamloops, made a turn at Ashcroft and the freight for the north country was all put off there and hauled up the Cariboo Trail. The climate in Ashcroft is very hot and dry in the summertime. Often temperatures are 110 degrees and 115 degrees with very little rainfall, averaging only about six inches annually. However, it is like Arizona; anything will grow if you put a little water to it. There were tomatoes raised. Aylmer's had a plant, which has closed down. When we first went in there were three small sawmills, only one of which is left.

Senator Connolly (Ottawa West): How many people live there now?

Mr. Reynolds: There must be around 1,800.

Senator Connolly (Ottawa West): Do most of them work for you?

Mr. Reynolds: We have 350 employees. Then there are all the other businesses that came in, such as stores and hotels. The mining companies have exploration crews in the area. Lornex will have approximately 600 and Highmont maybe 300.

Senator Connolly (Ottawa West): Have you by any chance made any projecton for your present property of what your taxable income might be under the present legislation for the life of the property and what it would be under the White Paper for the same period?

Mr. Steeves: Our effective tax rate will be approximately 42 per cent under the present tax system from now until the property is ended, in about 11 years. Under the White Paper proposals it will be approximately 55 per cent.

Senator Connolly (Ottawa West): Can you give the committee that in terms of taxable income or net profit?

Mr. Steeves: It is difficult because the price of copper is extremely volatile. This year our profits will be in the order of $10 million after taxes and we will pay $8 million in taxes.

Senator Connolly (Ottawa West): It would be at least 10 per cent less than that under the White Paper.

Mr. Steeves: It would be about $11 million taxes to get $10 million profits.

Senator Molson: What was the value of production last year?

Mr. Reynolds: Thirty million dollars.

Mr. Steeves: All exported.

The Chairman: All earning foreign exchange.

Mr. Steeves: Yes, U.S. funds.

Senator Connolly (Ottawa West): Suppose it was said to you that even after the White Paper tax provisions are in you are still in a profitable position, what answer would you give? You may be paying a few more taxes but, nonetheless, you are going to keep on going and you will be able to pay dividends to the shareholders.

Mr. Reynolds: Would we be able to say that? Yes. We are now in operation. We are out of debt. We do not have to get the risk capital. This has all been repaid, plus we have increased efficiency of our plant and its throughput to a point where we could operate, yes.

Senator Connolly (Ottawa West): Suppose I say to you all that is happening to you is that there is an increase in your taxes, but you are going to be all right?

Mr. Reynolds: We are going to be all right for 11 years, until this particular mine is mined out. However, we have to look for something else. We have to develop the mine. Last year we spent $1 million in exploration. We will spend almost $1 million this year. You have to, because your mine dies a little bit each day. You have to get out and find other mines.

Senator Connolly (Ottawa West): I do not want to put words into your mouth, but would this be a factor too, if your taxes do go up your prices are bound to go up?

Mr. Reynolds: We sell on the world market. The reason our profits were so high last year is that we have been selling copper on world markets, where there is a big demand. This demand is unnatural, because of the strikes that took place in the United States, what is happening in Chile and Peru, and all that did happen in Zambia and the Congo, although I think their mines are coming back on stream quite nicely.

Senator Connolly (Ottawa West): So your prices cannot go up and it will mean that your profits will not because you are paying a higher tax rate.

The Chairman: No, first your profits may well be less unless the market holds up.

Senator Connolly (Ottawa West): Of course the market is the important thing, but I am trying to isolate these things one from another. I know it is impossible really to do it, but in the end would you ever be in a position where you had to close down?

Mr. Reynolds: We would hope not. If copper prices ever got down to the break-even point, below break-even point, we would have to consider it, yes.

Senator Connolly (Ottawa West): So that the high tax rate imposed imperils continuation of your operation in the event of bad times?

Mr. Reynolds: I would say yes, except that at the break-even point there is no profit and no taxes. However, if you only make one dollar there are still some taxes and some profit.

Senator Laird: But at the end of 11 years you are going to fold up anyway, unless you can explore new fields?

Mr. Reynolds: Yes. These are approximate.

Senator Connolly (Ottawa West): I wondered whether on your present operation there was any serious peril to continuing the successful operation, which I find fantastic. I think it is a wonderful thing. I just want to satisfy myself that you could continue.

The Chairman: This is what happens once you are established and operating. What do you do? As long as you can make a dollar you keep operating.

Mr. J. Bruk, Solicitor, Bethehem Copper Corporation Ltd.: This is our main point. It is because of the tax incentive that we have today that companies like Bethehem were created and have become substantial taxpayers. We maintain it is for these reasons alone that we have such taxpayers. If the proposals contained in the White Paper were to be implemented, if would affect future growth more than the existence of the present companies. Their existence would be affected to the extent that free capital for investment would not necessarily be re-invested in the development of mineral resources in Canada but would go elsewhere, which would be the most attractive way of doing it.

Perhaps I may follow that up. We have a feeling from reading the White Paper that there is a philosophy permeating the White Paper that almost expects the mining industry to apologize for its success and growth in

the last ten or fifteen years. On the contrary, I think we have to be proud, as Canadians, for having created this fantastic industry. I do not wish to bore you too long with statistics, but if I may I would like to point out some statistics that some people seem to forget from time to time. I do not suggest you gentlemen do, but some people do.

First of all, the rate of growth of the mining industry has been indeed spectacular, doubling itself about every five years and growing faster than any other industry in Canada, including forestry, pulp and paper, agriculture and manufacturing. In fact, the mining industry has grown about twice as fast as the manufacturing industry in Canada, and much of this growth has been in western Canada. In 1969 Canadian mineral output exceeded $5 billion, accounting for over 7 per cent of Canada's gross national product.

The industry employs directly approximately 200,000 people, and its effect is felt by each one of us, as for every person directly employed by the industry it is estimated that approximately six additional persons find employment in related and service industries.

The mining industry also leads in average wages and salaries. Besides the effect on those employed by the mining industry, it is estimated that over 250,000 Canadians are shareholders in dividend paying mining companies, and our mining companies provide about 15 per cent of all Canadian corporate dividends.

The mining industry is Canada's biggest single exporter in terms of volume and value, with basic minerals and products now exceeding 30 per cent of our total export value. Mining has overtaken in the last few years such major exporting sectors as pulp and paper and agricultural products.

The mineral industry provides about 50 per cent of all railway revenue, and virtually all of the new railway lines have been built to service new mineral areas. The industry also uses 20 per cent of the electric power generated in Canada, and 20 per cent of chemicals produced in Canada are used by the mining industry.

Amongst the world mineral producers, Canada today, as a result of the incentives we have enjoyed in the past, is the leader in the production of nickel, zinc and silver, second in the production of asbestos, molybdenum, uranium, third in lead and gold, and fourth in iron, magnesium and copper. We are almost certain to improve our lead in copper.

It might be of interest to you to know that the industry has developed a high degree of expertise and know-how, and from my experience in international mining I would class the expertise and know-how to be the best in the world. Our productivity in mining is higher than any other sector of our mining economy, and the output per worker in our mining industry is higher than that of the United States. Mind you, our national produtivity average is only 75 per cent of the United States, while in the mining industry we are ahead of them.

The Chairman: Suppose I accept everything you have just said; I know it is gospel. Here is the language of the White Paper in paragraph 5.24:

> The government has concluded that special rules are still needed for the mineral industry, but...

This is the pertinent part...

> ...that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation.

Let us address ourselves to that for a moment. Unquestionably, your operation is most successful and profitable. How, in those circumstances, with that background, do we measure whether this segment of the industry is bearing its fair share of the burden of taxation?

Mr. Bruk: Fully to answer that question, the mining industry must be considered as part of the international mining industry. The mining industry is truly international. There is a misconception that Canada's mineral resources are so rich that they will be developed in any event. That is a fallacy. On that basis, how would you account for the nondevelopment of richer mineral resources such as those in Mexico, Russia, Australia, Africa especially South Africa, and in South America? It is a combination of factors that we have to date enjoyed in Canada that has accounted for this growth, and one of these factors is the tax incentive, which I think is the second largest factor, and probably the first in some cases.

To determine whether we are paying a fair share or not, one has to look at the overall situation not only at one company in isolation. In fact, there are thousands and thousands of mining exploration companies that raise money in Canada, explore for minerals and

never find any. There has to be an extra incentive; there have to be successes such as Bethlehem's to encourage people to develop mining. This is essential to mining. You cannot say that if a company like Bethlehem is successful, and in my submission is paying a fair share in taxes—as you note for this year, about $8 million...

The Chairman: The point is that you have some failures and some successes, but the White Paper seems to be dividing into categories the operations in this industry. The White Paper says that one catogory is a very successful operation and asks: Is that category bearing its fair share having regard to its profitability? You answer by referring to the many failures and all the money spent on exploration that never produces anything. It may be incentives that lead to this attempt to find a mine, but if they do not find a mine the tax incentives do not actually produce any benefits to the person trying to find the mine because he cannot use the tax incentives at that stage.

Is that a fair way of looking at it? That is to say, can we put the successful mining operation in a separate category and say: You only need so much, therefore by tax you do not need as much incentive and we should tax more from you. Is this a fair way of looking at it?

Mr. Bruk: I would philosophically disagree that the man who does not find a mine has not benefited from the tax incentives.

The Chairman: I did say what urges him to go is the possibility.

Mr. Bruk: It was the urging, the chance that encouraged us in Canada to be active to create, which is the greatest payment you can get from the tax incentive. You cannot take it company by company you have to look at the overall situation and see whether the industry as a whole is giving a fair share to the country as a result of its activities. I say we have shown to you by statistics that we have, because in our opinion there would be no tax revenue from mining if it were not for the tax incentives.

The Chairman: That may be true. I am not trying to argue one way or another on the White Paper. I am pointing out what the White Paper says and looking for an answer from you.

21851—4

Mr. Steeves: Mr. Chairman, I think in our brief you will see that we calculate the effective tax rate at 42 per cent for our mining company and mining companies in general in British Columbia. These are the successful operations. This is only eight percentage points below the stated maximum tax rate that is accepted by the White Paper. I believe this is little incentive to a company or an industry which risks the extreme amounts of capital in the exploration the larger amounts of capital put into the development and works itself out of business, so to speak, by the wasting nature of its assets.

In our case we have eleven years to run on our present reserves. I think the eight percentage points of incentive are justified.

The Chairman: I would think the two strongest points would be: one, that the mining industry should not in any event be taxed higher than what is recognized as being the breaking point for corporate taxation which is 50 per cent, in order to retain this differential and retain your capital to compensate for the wasting.

Is there another purpose for which you have retained earnings? Isn't that for further exploration and development in order to keep going? How would you relate that to what the White Paper says? If you just look at the profits you might say that they are so substantial that you really do not need these incentives in this form. Would the earned depletion allowance be enough for you, having regard to your stage of development and your earnings?

Mr. Steeves: In one word, no.

The Chairman: Why?

Mr. Steeves: Because the earned depletion is not enough incentive to encourage us to explore in this country. I think the incentives offered by other countries...

The Chairman: On the earned depletion, if you recognize the principle that you must explore and develop in order to keep going unless you are ready to wind up in eleven years then you are going to do exploration and development. Is the present allowance for that necessary or is the dollar of depletion for every $3 you spend enough? Of the $3 that you spend you deduct from your profits so that is money that you retained which reimburses you for what you spend. Then you get a dollar of depletion which is an extra. Now, why isn't that enough?

Mr. Steeves: To give an effect to the earning depletion in the White Paper, when you say you deduct from your earnings, first of all you have to consider that no company in Canada, including the mining industry, encourages expenses to create tax credits.

The Chairman: No.

Mr. Steeves: For each dollar you earn, even though you can deduct it from your income, you are only saving 50 cents on tax. With the $1 for $3 ratio you save another 16 per cent. I believe that is the figure.

The Chairman: You deduct $3 and you are really saving $1.50. If it were taxable you would pay 50 per cent tax?

Mr. Steeves: Yes.

Senator Molson: Mr. Chairman, I would like to suggest to Mr. Reynolds that perhaps some of the causes of the implication that the special treatment of the mining industry has given rise to inefficient and wasteful provisions is that depletion allowance continues for older mines much longer than necessary. Perhaps there is a feeling that mining investors are not only getting their alleys back but getting a whole bag of marbles back as well.

I am wondering if our witnesses have any suggestion that may tend to mitigate this critical view of their industry. For example, could they suggest that after 200 per cent of the cost of development had been repaid through depletion, depreciation, et cetera, allowances, that an established mine could well continue. There may be some limit—I suggest 200 per cent but it might not be the appropriate amount—after which it might be agreed that all the money invested in development of the property had been repaid. How would that affect well-established mines? What would be the mining companies' viewpoint?

Mr. Reynolds: May I start that by attempting to answer the question which Mr. Chairman asked here a few minutes ago. It will probably lead to an answer to your question.

First of all I think we have to look at this problem as being threefold and not try to wrap it into one package. The object of the three-year tax-free period is an incentive. The depletion is to take the place of wasting assets, since we cannot perpetuate our life. It is shortening every day.

The third thing is the tax on income. I think we pay as much as any other industry. When you separate them out this way I think that answers Mr. Chairman's question where he was quoting from the White Paper and asked about incentives. I think the way we would justify your question would be a lower rate of tax. We do not have a lower rate of tax. We have a rate of tax which is exactly the same as every other industry.

We have two other things if I may repeat, an incentive-free tax, and the third thing, a depletion allowance to make up to us for having a wasting asset. If we do not do something about it the shareholders will find their investments are worth nothing. At what point that incentive could be removed to some of the older mines I really do not know. For instance, we are setting up this new project on a 20-year basis at 100,000 tons a day. I think one of the things that makes it interesting for us is that we have the depletion allowance.

The Chairman: Maybe depletion allowances should be related to return of capital. If you are wasting assets then the money is supposed to stand in place of assets that have been used.

Mr. Reynolds: How do you value that?

The Chairman: This is the question. If the shareholders contribute a million dollars, ultimately when you have proven reserves you may have a value for those reserves which are recoverable over the years of many many times the million dollars. I was asking this question. I was not attempting to answer it as to how you would relate it.

When you talk about this, in regard to taking care of a wasting asset, obviously it means that the shareholders will have something at the end of the road when the mine runs out. How much should that be?

Mr. Reynords: And have a greater return while he is receiving the return. The man who invests in a manufacturing industry...

The Chairman: He is entitled, if he risks capital, to a good return on his money. He is gambling on getting any return.

Senator Connolly (Ottawa West): I suppose, Mr. Chairman, that there are physical difficulties encountered by any mining company. It is getting its depletion each year at the rate of 33 per cent. Not 33 per cent of a mine, but 33 per cent only on the production of that year.

The Chairman: Of the net production.

Senator Connolly (Ottawa West): In that year, yes or even a mine that has a very long life where there is a huge deposit comparable, say, to the tar sands deposit we talked about this morning. It is not 33 per cent each year of the total deposits. It is 33 per cent of what they take out.

Mr. Reynolds: Of the net profit.

Senator Connolly (Ottawa West): And the other point that I think was made by Mr. Steeves is that apart from the return of capital for a country like this, with climatic conditions such as we have and with vast unpopulated spaces, the element of incentive seems to be critical in an industry like the mining industry, in accordance with the way you explained it, in any event, and I think everybody who has been here from your industry has said the same thing.

Mr. Steeves: I think one of the points we have tried to make, and we have got a little bit away from it and I should like to come back to it, is that we are faced with a decision under the White Paper. All mining companies presently in existence will have to continue, no matter what the tax rules are, if they are at all viable.

Where the effects have to be felt are in future explorations and future development, and each mining company is faced, or at least B.C. mining companies under the White Paper are faced with knowing that if they are successful in the future they will be paying a tax rate of 56 per cent, as we have stated in our brief, whereas, to give Australia as an example of a place where it is very easy to calculate the effect of the tax rate, there it is 36 per cent.

It is pretty obvious where the best investment is, if other things are equal, and we don't believe conditions in this country are equal to some of the conditions in Australia. Nevertheless, we would rather stay here.

Senator Cook: Mr. Reynolds, would you care to estimate what the tax yield to the federal Treasury in 1959 was from Highland Valley?

Mr. Reynolds: In 1959 there wasn't any.

Senator Cook: What was the tax yield from Highland Valley in 1969?

Mr. Reynolds: We are the only people operating there as of now. There are two more mines ready. Our direct taxes, including the mining tax in British Columbia, come to $8 million.

Senator Cook: Would you care to make a guess at the following? Assuming that the Income Tax Act remains unaltered, that is, stays more or less as it is now, and things go well with some of these other companies, what do you think the tax yield would be in 1979?

Mr. Reynolds: I would think that the tax take there should be at least ten times what it is today.

Senator Cook: And today it is roughly $8 million?

Mr. Reynolds: The Valley Copper Mines project will be from six to seven times as large as our present operation. The Lornex property should be two and a half times the size. Then add ourselves. I would say about ten times. And then there are other mines that may come in as well.

Senator Cook: Looking at the other side of the coin for a moment, if the White Paper had been in effect since 1959, the tax yield from Highland Valley would have been the same—nothing.

Mr. Reynolds: That is right, nothing. We were not in existence.

Senator Cook: In 1969 the tax yield from Highland Valley would have been what?

Mr. Reynolds: Nothing, we think. We attracted the Sumitomo Companies and they put up the first $50,000 to have us finish the exploration and do a feasibility study. We had one feasibility study done by a firm of engineers. When we sent it to Japan the figures were so close that they had us engage a second firm of engineers at a cost of $25,000 to do the feasibility study again to make sure that it could be done and that they could be paid back their money. That was how close the figures were.

The Chairman: Your question, Senator Cook, was that if you paid taxes of $8 million in 1969 under existing conditions, what might that $8 million have been if the White Paper provisioss had been in force since 1959. I think that was your question.

Senator Cook: My question was if the White Paper had been in force since 1959 what would the tax yield be from Highland Valley in 1969.

Mr. Reynolds: And we think it would be zero.

The Chairman: Why zero?

Mr. Reynolds: Because we would not have gone into production and we are the only taxpayers at the moment.

Senator Cook: And if the present rate continues in force from 1969 to 1979, what would be the yield?

Mr. Reynolds: If our present tax structure is maintained it will be about ten times what we are paying today.

Senator Cook: My point is that if the White Paper was continuously in force in 1969 I gather the tax yield would still be nil under the White Paper.

Mr. Reynolds: I would think so.

Senator Phillips (Rigaud): Have you any funded debt?

Mr. Reynolds: No, we have paid it all off.

Senator Phillips (Rigaud): Reference has been made to speculative moneys or risk moneys coming in based upon reasonable and morally equitable rules, and the thought has been expressed that it is not fair, say, to change the rules in the middle of the ball game or in midstream, to mix metaphors. Is there any merit to the suggestion that the present depletion allowance should be allowed for a defined period of time before revised rates come in? Let us assume that we were to say that the present depletion allowance should remain in force as it is now for a period of five years before the revised rates came in, and in terms of reasonable compromise to offset the problem of all taxpayers bearing their fair share of the load of taxation, the right of Government to change the rules as we go along as against the unfairness of changing the rules in relationship to risk moneys that came in, having regard to the international competition involved in the mining industry, do you think it makes sense to consider a flat five-, seven- or ten-year period with the present rate of depletion as constituting a transitional period that would over-all be fair to the natural resource industries?

Mr. Reynolds: You have asked two questions, or at least your question is in two parts. The first part is would the five years be a fair time for the original or larger rate. Five years I would question, because it is usually in the first five years of production that mines under the present rules don't pay tax. They have a three-year tax-free period.

Senator Phillips (Rigaud): I am speaking of five years from now, if the White Paper were implemented. We would say that the present depletion rate would be allowed to the existing mines for a period of five years. Thereafter you are bound by the new rules that may be in force at that time.

Mr. Reynolds: And what rules would you suggest might be applied to the future mines?

Senator Phillips (Rigaud): The new rules, I am trying to answer what appears to me to be a legitimate argument about capital being induced to take a risk in opening up virgin territory and risk its money as against the mobility that it requires in Government to change the tax rules. They change it on you and on me and on everybody else as we go along in an annual budget.

What would be the fair base of saying to the natural resource industry of this country, "All right, you put in equity money; you borrowed money; you came in on a certain basis to open up virgin territory," et cetera. "We now have to change the rules. Would a five-, seven- or ten-year period on depletion allowance be a fair transitional period?"

Mr. Steeves: In the White Paper there is a five-year transitional period on the switch-over of depletion. This is to fulfil a moral obligation, I guess, to these people who have committed a lot of money to exploration. An extension of that would be a relief to the same people, I think, but it is a temporary relief. It does not solve the problem that we have been trying to point out today.

Senator Phillips (Rigaud): I know.

The Chairman: What I was pointing out to you is that the White Paper seems to divide this thing. I have not yet had an answer that appears to be a satisfactory answer. Is that a proper way to look at this problem, to put it into categories? Is it proper to take the mines that are worked well and are highly profitable as examples for devising rules of the kind which they have in the White Paper? It does not make sense that they should approach it that way.

Mr. Bruk: There are two aspects to this question. One is the inducement that we should continue and develop and come up with taxpayers such as Bethlehem. But at the same time there are many of those who are not successful. As I say, there are two parts to your question, and now it is the overall effect—when the White Paper says that all

taxpayers should contribute equally, it is equality in the rate of equality in the contribution. But our contention is that the mining industry is contributing more than equally by reason of the development it is creating and the further opportunities for tax revenues, so you cannot put them on the same basis because of this distinct nature of the industry.

To go back to this question that was asked earlier, it is important for these people who have invested, and this includes the Canadian public, in the companies that are now being developed, that the rules of the game should not be changed and here I would specifically refer to development that we all know, the Anvil Mining Corporation in the Yukon, in the wilderness about 250 miles from Whitehorse. It is a huge development, and the Canadian department financed its share by selling to the public in Canada on the basis of the projections made before the White Paper came into effect. Therefore you cannot change the rules now. People would not have invested on a much lesser return anticipated than was presented to them at the time.

The Chairman: Well, you have two categories; one category is the operating mine, and the other is the people who explore and develop for the purpose of developing new mines. Now they have laid out a chart—for what the people expect when they are going to explore and develop new mines—they have laid out a chart as to the terms which they may enjoy by way of incentives. The question is whether those incentives in relation to exploration and discovery are enough to encourage people to explore, etc. Then there is the second question with respect to operating properties which are making money. How should they be treated? Obviously they should not be taxed at a higher rate than other business. And surely, if your combination rates run at 56 per cent now, then you are being taxed at a higher rate under the White Paper proposals.

Mr. Steeves: I think the best incentive is the knowledge of the lower tax rate once you are successful, rather than trying to tie your incentives entirely to exploration.

The Chairman: When you say that special rules are needed in the mining industry because it is risky and speculative and then you devise rules that do not appear to have any special incentive value—that is about the real test.

Mr. Steeves: I agree.

The Chairman: But it does not deal with the other question about successfully operating mines that are making substantial profits. Now what is the maximum that they should be subjected to? Obviously not any more than other corporations pay. But then, having regard to the fact that you want them to continue exploration and development, what is the carrot that you have to put out there to encourage them because otherwise it would be better for the shareholders to run out the mine and take their money.

Mr. Steeves: Well, it is obvious that the present incentives have been successful, and this is what we consider to be the proper way of handling this.

Senator Connolly (Ottawa West): Could I follow up the question that Senator Phillips (Rigaud) asked in relation to the points the Chairman also discussed. You say first of all that the present incentive legislation is good and should not be disturbed. And Senator Phillips (Rigaud) says there are people who look at the successful mines and say "well, even if the taxes are increased, they are still going to run at a profit." And you want to keep the incentive element there because it encourages further exploration, further development and more wealth and consequently more taxes. Would there be anything wrong with using the present laws and applying them to the new mines discovered for a period after they come into production? Let us say by giving them a three-year tax exemption and then give them a certain stated period of depletion, say five years or something like that, perhaps even 10 or 15 years. I personally do not think so, because I feel that the depletion is only related to the amount of production in a given year and is not related to the ore body in question. But would a formula of that kind provide a kind of incentive to keep the mining industry running at a higher level in Canada?

Mr. Reynolds: There is that possibility if you had the tax-free period and the rules as to write-offs as you have them today, that is your pre-production costs, and then added certain things that are not even under the present act that are somehow inequitable—they were brought into the write-off—and then after a number of years of successful operation, reduce the amount of depletion allowed. It certainly would not put a mine that was out of debt out of business. Now unless that mining company was finding new

mines, it could lose a number of its shareholders, but I don't know how serious that is.

Senator Burchill: Does not the present act in respect to incentives compare very favourably with the United States laws?

Mr. Reynolds: I think we are paying a higher rate of tax. As Mr. Steeves said in his submission, even today we are paying—let me put it this way, if our mine were located in the United States, we would be paying less tax than we are paying in Canada today.

Senator Burchill: I was thinking more of incentives, is that included in that too?

Mr. Reynolds: Yes.

Mr. Steeves: The percentage depletion allowances in the States are generally...

Senator Burchill: What about the tax holiday?

Mr. Steeves: There is no tax holiday, but the percentage depletion is more generous. When you consider a mine over a long period of time, say 20 years, as I have done in my address, the American incentives appear to be more generous. However, I think the tax-free period should not be discounted because this has been of great assistance to low-grade mining companies in Canada in recovering their investment quickly and still having, with the depletion allowance, a reasonable taxation rate.

The Chairman: Honourable senators, I am afraid I have to leave at this stage. I will ask Senator Phillips (Rigaud) to take the chair.

Senator Phillips (Rigaud): Is it in order that I take the chair?

Hon. Senators: Agreed.

Senator Lazarus Phillips in the Chair.

Senator Molson: Mr. Chairman, I think your question of a few moments ago and Senator Connolly's shows that most of us are fumbling for something we are trying to get out of these gentlemen and we are not achieving it. Now I raised this question of old mines and depletion decreasing at some stage at which they would not find themselves in disfavour because they were getting a special benefit. That is when all the element of risk would have disappeared, when they were fully established, or had paid back or had earned back their complete capital. At this stage I think that it is felt that the mining industry is now getting a particular benefit, and I feel this is possibly one reason why we have some of these items in the White Paper. I think we are all fumbling to see if there is not some suggestion for a change that would eliminate this element of criticism without harming the mining industry, because I think that we are all fully convinced that the mining industry in Canada is one of the most essential and vital elements we have.

The Acting Chairman: I agree with you, Senator Molson, and that is why, gentlemen, we are pressing this point, because in due course we have to deal with the problem. The White Paper is making alternative suggestions. If we were in agreement with the alternative suggestions that would end that, but on the assumption that we are not in agreement—and there have been expressions here from a good many of the senators that we are not quite in agreement with the views in the White Paper—at least, from some honourable senators—the question is still left: What does this committee recommend as being a middle-of-the-road plan which recognizes the tremendous contribution made by the industry, the risk factors that are involved, the necessity of being differentiated from other companies because they must look for further mines—if you take all those factors into consideration, but then polarizing it, you may have a company that does not engage in any further exploration but makes tremendous profits and is continuing to obtain this depletion allowance of 33⅓ per cent. How do we meet a segment of public opinion that reacts? Is that it?

Senator Molson: That is it. I am thinking of the Texas oil millionaires; I am thinking of rich mining people; and I am thinking of some of the criticisms these gentlemen are getting. I am trying to ask them if they can suggest to us a way that would benefit them, if you want, and benefit the country.

The Acting Chairman: That is right.

Mr. Reynolds: Mr. Chairman, I think this is a very interesting and proper question to put to us. I believe the Mining Association of Canada is giving you a brief shortly?

The Acting Chairman: Yes.

Mr. Reynolds: I wonder if we could refer this specific question back to the Mining Association and see, when they come before you, whether they would have an answer for you.

The Acting Chairman: I think it would be very helpful indeed if you transmitted prior to their arrival here that this committee is—it is not for me to say whether we are sympathetic or not to the needs of the industry, but we are bothered about one aspect of the problem and we require clarification.

Senator Everett: Coming to your specific recommendations regarding depletion, on page 11 of your brief, you say in item (a) that the present depletion allowances should continue, but with a minor adjustment in order to make the allowances competitive. Is that a downward adjustment?

Mr. Steeves: Yes, possibly a downward adjustment. On the premise that the tax-free period would continue, we think the present percentage depletion could be adjusted, but the caution is it would have to compare with the other incentives offered by other countries.

Senator Everett: Coming to a paragraph on page 10 you state:

> It must be recognized that, because of Provincial Mining Taxes, the present percentage depletion only reduces the effective tax rate for mining companies by approximately 8 per cent...

Then you go on to say that the net rate in British Columbia is 42 per cent. That is based on a 33⅓ per cent depletion, and yet in your recommendation you state the percentage must exceed 16 per cent.

Mr. Steeves: Yes.

Senator Everett: Would it not have to exceed 33⅓ per cent?

Mr. Steeves: The 16 per cent is in the (b) part.

Senator Everett: I think it is in the (a) part, if you look.

Mr. Steeves: Yes, I am sorry. The 16 per cent would reduce the effective tax burden of a B.C. mining company to 50 per cent. Any incentive that would be offered would have to be in excess of 16 per cent to get the tax rate below 50 per cent.

Senator Everett: You are not suggesting that the 50 per cent would be sufficient?

Mr. Steeves: No.

Senator Everett: So 33⅓ per cent is probably your minimum?

Mr. Steeves: 33⅓ per cent would bring it to 42.

Senator Everett: Yet you say it could be adjusted down, and you talk as though it could be 25 per cent or 20 per cent.

Mr. Steeves: What I have tried to say in the (a) part is that if percentage depletion is to be adjusted because it is felt that the mining community is not paying a high enough burden of tax, you would have to start with the 16 per cent depletion in any case to get down to the 50 per cent, and then any incentive you are willing to offer—and the White Paper does say incentives are to be offered to the mining industry—would be in excess of the 16 per cent. 33⅓ per cent will bring us down to our present 42 per cent.

Senator Everett: But you suggest it could be lower.

Mr. Steeves: We would not like it to be, but if this was the decree then it should be the consideration.

Senator Everett: You go on in (b) and say:

> Allowing Provincial Mining Taxes to be deducted from Incomes Taxes...

And then you go on in (c) and say:

> Allowing Mining Taxes as an offset against Income Taxes...

Would you tell me what the difference is between these two?

Mr. Steeves: Those are the same.

Senator Everett: So this would just be a credit against federal taxes?

Mr. Steeves: Yes, under the present system mining taxes are a deduction, but only a partial deduction, and the formula has to be worked out. They are partially deducted from taxable income.

Senator Everett: What would be the result of a tax credit equal to the B.C. mining tax?

Mr. Steeves: Then you would be starting at a 50 per cent base and any incentive that could be offered would be either by a percentage depletion or earned depletion that would be calculated after that. That is where the 16 per cent that I have in that paragraph (b) would give us our present 42 per cent tax.

Senator Everett: Which you do either by depletion on net or an earned depletion?

Mr. Steeves: It could be a percentage depletion or an earned depletion.

Senator Everett: Tell me, does the idea in the White Paper that the depletion allowances could be accrued and carried forward have any effect on the 42 per cent?

Mr. Steeves: No, not really, because the maximum depletion allowance that is allowable in any year is to remain at 33⅓ per cent.

Senator Everett: But under the present system it is not carried forward?

Mr. Steeves: It does not have to be because it is only payable on profits; it is always one-third of net.

Senator Everett: That is right, but is it not true that under the White Paper you could pile up depletion allowances?

Mr. Steeves: Yes.

Senator Everett: But would there not be some effect on future reduction of income because you are taking a greater depletion over a longer period of time? In other words, you are starting earlier to take the depletion than you would normally in the operation of a mine?

Mr. Steeves: I disagree with that a little.

Senator Everett: You are the expert, so...

Mr. Steeves: It is only taken on profits, and you would always take your maximum depletion and would have no incentive to carry it forward unless your profits were too low to absorb it. Really, I do not think the carry-over provisions should be given too much weight. I think they are helpful, but I do not think they should be given too much weight.

Senator Everett: Coming to your table on page 13, I think what you are attempting to show there, if I am correct, is the fact that all these deductions that a mining company is entitled to are really of no value at all if the mining company decides to pay out dividends.

Mr. Steeves: They are lost under the White Paper. The incentives we have to mining company dividends now under the present income tax are quite an incentive, but under the White Paper the incentives even offered to the company are lost.

Senator Everett: Let us look at the White Paper proposals. If instead of having a dividend paid to the shareholder of $6,000, the dividend were $9,000 which was the actual cash flow, as I understand it from your example, what would the effect be then?

Mr. Steeves: The actual cash flow is $6,000 in the example in both cases, senators.

Senator Everett: Yes, you are right.

Mr. Steeves: To illustrate the effect I wish the graph had come out a little stronger, but I would refer you to the bottom line in Appendix I which shows...

The Acting Chairman: To which appendix are you referring now?

Mr. Steeves: Appendix I. Under the present Income Tax Act the taxation burden on profits earned by a mining company, by the time they pass through to a shareholder, is shown on line 1, or the bottom line, and the present taxation burden in respect to other companies is shown in line 2 which, as you can see, is close to the top. This difference is the present depletion allowance on shareholders' dividends.

Under the White Paper the mining industry goes up to line 3, which is the top line, and the other industries come down to line 4, which is the line second from the bottom. So, what we are showing on the graph is that under the present tax system shareholders in mining companies are given an advantage because of the risk of investment in the industry, but under the White Paper proposals they will bear a higher tax burden than investors in other industries.

The Acting Chairman: It is the reverse?

Mr. Steeves: Yes, it is the reverse. I wish the graph had highlighted this a little more, but it is a considerable increase in tax burden.

Senator Everett: Going back to the table on page 13, and to your statement that non-resident shareholders have an advantage under the White Paper, can you demonstrate for us on the table on page 13 how the non-resident shareholders under the White Paper proposals would benefit over the Canadian shareholder whose situation is shown here.

Mr. Steeves: This graph does not illustrate the position of a non-resident. The non-resident remains liable only for the withholding tax.

Senator Everett: I realize that it does not, but I am asking you what would be the situation of the non-resident.

Mr. Steeves: The non-resident—and we will assume he is in a treaty country—would be liable for the 15 per cent withholding tax under either the White Paper proposals or the present Income Tax Act.

Senator Everett: But under the White Paper proposals where the marginal rate is 50 per cent, the taxpayer is liable for a tax of $2,250; is that correct?

Mr. Steeves: Yes.

Senator Everett: What would he be liable for if he were a non-resident shareholder in a treaty country?

Mr. Steeves: He would be liable for $900, or 15 per cent of the $6,000.

The Acting Chairman: Which is the withholding tax?

Mr. Steeves: Yes.

The Acting Chairman: I want that on the record. The difference is between $2,250 and $900?

Mr. Steeves: That is right.

Senator Everett: I have one last question. You state at the top of page 14:

> We believe that the requirements to pay out profits to shareholders within two-and-one-half years places an unwarranted burden on mining companies and should be rejected.

Then you go on to say that the suggestion to substitute stock dividends is not a satisfactory solution. Further down the page, though, you say that there should be no difference between widely-held and closely-held corporations. You state:

> Canada cannot afford to experiment with taxation policies that have proven undesirable and unworkable in other countries. We strongly recommend the abandonment of the integration concept, and the retention of the dividend tax credit system of our present income tax act.

Now, can you tell me, if the tax dividend credit system is sound for a public company, what is going to happen to the locked-in surpluses of the private companies under your proposal which states that there should be no integration, no forced pay-out, and no stock dividends; there should be purely a tax dividend credit? Are you not going to perpetuate the problem that both governments and shareholders face with the locked-in surplus of closely-held corporations?

Mr. Steeves: I believe that in many instances closely-held corporations are what we commonly think of as smaller corporations, and the locked-in surplus to them is not as much a factor as is the loss of working capital occasioned by the pay out of dividends. I think the White Paper is primarily concerned with the deferrment of the taxes that are generated. To state a personal opinion, I believe that one of the concerns of the White Paper has been the dividend stripping policies of the past which I think have been adequately stopped by recent tax legislation. I do not think the abandonment of the tax dividend credit system and the acceptance of the integration proposals will be a benefit to even a closely-held company. Those are my personal opinions.

Senator Everett: Why do you say that?

Mr. Steeves: Because they can still get it out as they need it, or want to get it out. Section 105 is still in the act. You can pay a 15 per cent tax and take out your dividends. I think that this is adequate for people who need to get the money out of a closely-held corporation. I think it allows the Government to take the additional taxes. But, it also provides a way by which the closely-held company can retain working capital in the business if it is required. I think if you have ever been involved in the administrative problems and costs of issuing stock dividends, particularly the widely-held company, you will agree with this. Mr. Bruk or Mr. Thiessen could probably elaborate on this better than I can, but it is our opinion that this is not a solution.

Senator Everett: That is, for the widely-held corporation.

Mr. Steeves: Yes.

Senator Molson: Mr. Chairman, I want to ask two completely unrelated questions.

First of all, I should like to know the price of copper in 1962 when the Bethlehem Copper Corporation went into production.

Mr. Reynolds: It was 28½ cents U.S. a pound. That is based on the Engineering and Mining Journal export and refinery price at New York.

Senator Molson: And in December of 1969 it was how much?

Mr. Reynolds: In December it was about 68 cents.

Senator Molson: That is on the same basis?

Mr. Reynolds: Yes, on the same basis.

Senator Molson: I am asking my second question on behalf of Senator Connolly. He was wondering whether you would feel that whatever the rate might be the same rate on depletion should apply to base metals such as nickel and iron, precious metals, non-metallic minerals, and so on, or do you think that consideration should be given to there being different rates. In other words, is this a mining problem or a problem that relates to certain portions of the mining industry?

Mr. Reynolds: It is a straight mining problem, an industry problem, because you find copper and silver in many parts of Canada. The problems in the finding and mining of all minerals and metallic materials are similar. I do not know anything about the oil business.

Senator Molson: No, I left oil out of this; these were all mining.

The Acting Chairman: The fourth paragraph in page 14 of the brief states:

> The integration system has been tried in the United Kingdom and has been repealed. In a report by Price Waterhouse & Co., of London, England, the reason for abandoning the integration concept was "increasing difficulty in applying a tax system which united the personal circumstances and taxable potential of individual shareholders with the basis appropriate to the taxation of company property. Profits earned by companies have long ceased to be regarded as income of their shareholders."

When you use the expression "the integration system", I take it that you refer to the proposed integration system referred to in the White Paper?

Mr. Steeves: Yes.

The Acting Chairman: You say that the system contemplated in the White Paper is one that heretofore had been experienced in the United Kingdom and has been repealed because of its inefficacy.

Mr. Steeves: Yes.

Senator Everett: You raise the point somewhere in the brief that under the integration system it is going to be difficult to get out portions of surplus that are not defined as undistributed income.

Mr. Steeves: Yes, I am glad you brought that up. It is a part of our brief that is not contained in the White Paper. It appears on page 15 and is headed "Dividends from Tax Free Surplus Created Prior to Implementation Day." This is a most important point. Mr. Reynolds mentioned that we have recently had a rather large treasury share issue in our company which has created a large amount of what we refer to as contributed surplus. It is not taxable under the present act, but if the White Paper proposals are put into effect distribution of this to the shareholders would be taxable although it was put into the company by the shareholders. This is the difference between the par value of the shares and the price for which we sold them. In our company it amounts to something like $23 million. We consider this to be inequitable when it was taxed prior to the implementation of the White Paper and is just a contribution by the shareholders.

Senator Everett: Why do you not just pull it out now?

Mr. Steeves: Because we cannot afford to pay out $23 million in dividends.

Senator Everett: What about in stock dividends?

Mr. Steeves: We cannot afford to pay out $23 million in stock dividends.

Senator Everett: Why does it become post-White Paper?

Mr. Steeves: Because it will be taxable if it is taken out after the White Paper.

Senator Everett: But you ask you cannot take it out and you cannot issue a stock dividend to cover it?

Mr. Steeves: Not now.

Senator Cook: Not now, but in the future?

Mr. Steeves: We will in the future probably. Contributed surplus is generally the last item that comes out of the company on liquidation.

Senator Everett: But you are not referring to liquidation but to retaining the contributed surplus.

Mr. Steeves: My point is it was created prior to implementation at a time when it was not taxable and after the implementation

of the White Paper it will become taxable in the shareholders' hands.

Senator Everett: My point is that there are a lot of people who are going to be in that position if they do not pay out what is not defined as undistributed income. However, in your case it does not look as though you have any intention of paying it out anyway, but you raise a good point for other people.

Mr. Steeves: There is a distinction between undistributed income and retained earnings. This is not retained earnings but a contribution by the shareholders. There is equity in taxing distribution of retained earnings that were created prior to the White Paper as they are now, but my point is that these are not taxable now and I do not believe they should be taxable merely by implementation of the White Paper proposals.

Senator Everett: Your point is well taken, but in addition to that point capital gains, for example, are not defined under the White Paper as undistributed income. Therefore they might attract full tax rates under the White Paper, whereas undistributed income which is for the main part accrued profits would be 15 per cent. At what rate do you think your contributed surplus would be taxed?

Mr. Steeves: It could be taken out at 15 per cent, in the same way.

Senator Everett: I think our tax adviser would argue that point. We have a paper which indicates that it could come out, on his reading of the White Paper, at full tax rates.

Mr. Steeves: I have great respect for your tax adviser and I would not argue the point. I understood that this would come out under section 105.

Senator Everett: Prior to the White Paper?

Mr. Steeves: No, subsequent to the White Paper.

Senator Cook: It would only be capital gains after valuation day, not before.

The Acting Chairman: No, we are referring to capital gains presently forming part of the surplus of a company in respect to the capital gains heretofore realized.

Senator Everett: Do you think section 105A will be operative after the White Paper comes in?

Mr. Steeves: I understand it will.

Senator Everett: What section of 105?

Mr. Steeves: The payment on capitalization of undistributed income equal to the amount of dividends they paid.

The Acting Chairman: Under one of he subsections you can capitalize your undistributed income at the effective 15 per cent rate.

Senator Everett: Section 105A is 15 per cent on an amount equal to the dividends you declared. Section 105B is 16⅔.

The Acting Chairman: More or less. As a matter of fact, if you consult a tax lawyer you will find it is between 15 per cent and 16 per cent.

Senator Molson: Mr. Steeves is saying that contributed surplus is money which has already paid any tax which it legitimately attracted. If there was any tax payable it has already been paid and therefore it should not be taxed on distribution to the shareholders.

Mr. Steeves: That is correct.

The Acting Chairman: Honourable senators, are there any further questions? None. We wish to thank you, gentlemen. Will you be good enough to file the documents that we have requested and convey the information to the Mining Association.

The committee adjourned.

APPENDIX "A"

SUBMISSION TO: The Chairman,
Standing Senate Committee on
Banking, Trade and Commerce,
The Senate,
Ottawa, Ontario.

FROM: Hollinger Mines Limited,
Suite 601,
1155 Dorchester Boulevard West,
Montreal 102, P.Q.

SUBJECT: The White Paper on Proposals for Tax Reform and the detrimental implications of some of its proposals to the Canadian mineral industry and to Canada's future.

SUBMISSION TO: The Chairman,
Standing Senate Committee on
Banking, Trade and Commerce,
The Senate,
Ottawa, Ontario.

FROM: Hollinger Mines Limited,
Suite 601,
1155 Dorchester Boulevard West,
Montreal 102, P.Q.

SUBJECT: The White Paper on Proposals for Tax Reform and the detrimental implications of some of its proposals to the Canadian mineral industry and to Canada's future.

Summary

An examination of the proposals of the White Paper on Proposals for Tax Reform as they would apply to the Canadian mining industry leads to the following observations and conclusions.

1) The nature of the mining industry is fundamentally different from that of any other industry. A mining industry can emerge and expand only when and where its particular characteristics are recognized and satisfied by applicable taxation laws.

2) Mining is essentially an international industry with respect to the occurrence of mineral deposits, the capital required to seek, find and develop deposits, and the pricing of ore and minerals. To maintain and expand its mineral

industry, Canada must be able to compete successfully with an increasing number of mineral-producing countries which provide the incentives necessary for the expansion and development of their own national mineral industries.

3) The contribution of a healthy mineral industry to the economic well-being of Canada is enormous, and not widely recognized. This contribution is measurable in terms of direct employment, indirect employment, the generation of foreign exchange and the development of hundreds of communities which, without the industry, would not have come into existence. The beneficial effects of Canada's mining industry are so deeply integrated into the economic fabric of the nation that it is impossible to do economic injury to this industry without doing injury to the national economy.

4) World-wide demand for minerals has been rising and will continue to rise, a situation which offers opportunity to Canada. The growth of Canada's mineral industry in the last quarter century, which has a parallel in the economic growth of the country, offers ample evidence of the national benefits to be derived from grasping the opportunities offered by a rising demand for minerals. Equal opportunities exist in the decades ahead. Canada will seize or lose these opportunities in accordance with the manner in which

the tax structure recognizes and satisfies the unique character of the industry.

5) We submit that the proposals of the White Paper on tax reform do not satisfy the conditions necessary to sustain and expand the mineral industry in Canada. The proposed change in the method of calculating the depletion allowance for operating mines and the existing three-year tax exemption on new mines will destroy the economic vitality of the industry, precipitate its decline and deny Canada many of the economic advantages now derived from the industry and all the advantages that should be derived from an expanding industry.

6) It is our opinion that the tax provisions now applicable to the industry should not be changed.

The officers and directors of Hollinger Mines Limited wish to preface this submission with an expression of appreciation to this committee for extending the opportunity to submit opinions with respect to proposals advanced in the White Paper on Proposals for Tax Reform. We shall limit our comment to those particular proposals which have a bearing on the future of the Canadian mineral industry.

It is our conviction, after serious study, that the changes proposed, particularly with respect to the depletion allowance on mining operations, and the three-year tax free period, would jeopardize the future of the industry in Canada. This being so, it would diminish for all Canadians the advantages now being derived from an industry with a record of massive contributions to Canada's economic and geographical development and would deny to them the potential advantages from even greater contributions to Canadian progress which the industry should be able to make.

Hollinger submits these opinions from a background of participation in the Canadian mining industry that has continued all through this present century. The founders of the company, modest northern merchants, participated in the silver mining industry in Cobalt at the beginning of the century. Later they developed the largest producing gold mine in Canada's history--

the Hollinger mine at Timmins, Ontario. The company was instrumental in the development of several other mines in Ontario, Quebec and Labrador. It pioneered the development of producing iron ore mines of the Quebec-Labrador Trough. In the course of its history as a mine developer, it has participated actively in one of many distinctive and constructive characteristics of the industry--the development of new Canadian communities in the Canadian northland.

The unknown industry

Most mining exploration programs and, as a consequence, most mining operations are conducted far from the densely populated urban areas of Canada. This situation creates the basis for a number of misconceptions and a wide information gap with respect to the economics of the industry and the role it plays in the economic health of Canada.

The successes of the industry, that is the successful discovery and development of profitable properties, are highly dramatized in our news media. Its failures, or unsuccessful investments, are largely ignored. The success it experiences is popularly associated with the lucky find or the rags to riches lore which surrounds the industry. It gives little cognizance to the highly technical, highly costly and risky nature of the search that goes on continually for new mineral deposits which

make the occasional success possible. Popular views to the contrary, it is this calculated risk of exploration funds which leads to mineral development.

Another consequence of the remote geographical location of most mining operations is that the national benefits flowing from a successful mining operation are injected unobtrusively into the economic bloodstream of the country and are not widely recognized by the majority of the population. These benefits include direct employment on the property, multiple indirect employment generated through purchases, the generation of foreign exchange in massive amounts, and the unmatchable record of the industry in regional development throughout the entire country.

A further effect of the geographical location of most mining operations is a paucity of understanding of the particular economic circumstances which govern the industry. These include such facts as the high cost of finding an orebody, the non-renewable nature of the orebody once it is found and worked, the international nature of the industry with respect to risk and development capital as well as the international nature of mineral markets and mineral prices.

We submit that these elements are peculiar to mining and highly relevant to any study on tax reform as it affects this industry. We believe that the White Paper on Proposals for Tax

Reform does not exhibit an understanding of these economic elements and, as a consequence, if enacted into law, the proposals it contains would amount to discrimination against the industry, leading to a decline in its vigour that would have serious repercussions in terms of reduced employment throughout Canada, reduced tax revenue for governments and a drastic reduction in the volume of much-needed foreign exchange it now generates.

BASIS OF OBJECTION

The particular proposals of the White Paper which, if implemented, we believe would have the most inhibiting influence on the growth of the mining industry, and therefore on the economy of Canada, are those dealing with:

the change in the method of calculating the depletion allowance for operating mines;

the three-year tax exemption on new mines.

These present provisions represent tax incentives of proven value to the industry. They are, of course, no more liberal than the tax incentives offered by competitive mineral-producing countries around the world. But they have been sufficiently effective to amount to a first-class national investment. We do not believe the proposed substitutes for these considerations to be realistic or useful.

Need for incentives

The existing provisions of the Canadian tax structure were specifically intended to stimulate the growth of the mineral industry, as in fact they have done. Other types of incentives, such as tariff protection, Government grants, accelerated depreciation and similar allowances to new industries in designated areas, have been employed to stimulate the growth of other types of industry, and they too have been effective. Those applicable to mining, however, were of a nature designed to fit the particular needs of the mineral industry, which is inherently different from other industries.

It is commonplace to observe that each industry is different, but the case for incentives for mining rests not on the fact that it is different in detail, but on the fact that it is fundamentally different. The essential differences are in the nature and extent of the risk involved in finding new, commercial orebodies and in the diminishing nature of the orebody once work begins on it.

Our opposition to the changes in taxation procedure proposed in the White Paper is based, primarily, on a number of concepts, many of which are not widely comprehended. They include:

1) The mineral industry represents a large and important segment of the Canadian economy. It has grown to importance under progressive tax provisions conducive

to its growth. To exchange these progressive provisions for retrogressive provisions would result in a loss of momentum to the industry which would have adverse effects on all Canada.

2) Since the era of railway building, the mineral industry has been the greatest single force in Canada leading to the development of new regions, particularly in what was or now is the Far North. Anything that impedes the growth of the industry would impede this process without providing any reasonable alternatives to stimulate such growth.

3) The well-being of the Canadian economy, which benefits all Canadians, requires vast amounts of revenue obtained by selling Canadian products in foreign markets. Governments continue to encourage exports for this reason. The Canadian mineral industry provides Canada, through export merchandize, with about 30 per cent of its foreign exchange. To jeopardize this source of foreign exchange would be hazardous to the entire economy of the country.

4) The industry achieved its status on world markets in the face of intense and rising competition from many other large mineral-producing countries. Most, if indeed not all, of these competing countries grant their mineral industries comparable or in some cases better incentives than those available to Canadian producers. Whether Canada continues these incentives or not, the fact remains that comparable incentives will be continued by competitor countries. To withdraw them from Canadian producers would place Canada at a serious competitive disadvantage in markets now providing so much of the country's foreign exchange.

5) The Canadian mineral industry has a great potential for immediate growth, and to grow it needs foreign investment capital. All Canada would be the beneficiary of such a growth. The implementation of the proposals of the White Paper as they affect the mineral industry would discourage investment capital from Canada and abroad. It would initiate a decline in the industry rather than encourage growth. Such a decline would deny to Canadians the benefits they should derive from

a native industry that can and should grow.

6) A decline in the foreign exchange yield of the mineral industry would not be offset by a comparable rise in exports from any other sector of the economy. The withdrawal or dilution of incentives now applicable to the Canadian mineral industry and which have proved so useful to the entire Canadian economy would deprive Canadians of economic advantages they now enjoy without replacing them with comparable long or short term advantages.

We would like to develop these opinions as briefly as possible in the context of the industry and the Canadian economy.

CANADA'S MINERAL INDUSTRY

The mineral industry affected is based on more than 60 mineral commodities dispersed irregularly throughout 3.8 million square miles. It is an industry that has expanded more than 600 per cent in the past 20 years. By normal standards, it is not a large employer of labour: it gives direct employment to approximately 150,000 people. By circumstances peculiar to the industry, however, it indirectly sustains the employment of a much larger segment of the Canadian work force. It uses the services of many other industries for process supplies, fuels, electricity, construction materials, food, clothing, freight and many forms of transportation. By practice, it buys Canadian goods. It pays high wages and thus makes heavy consumers of employees' families. These conditions have the effect of providing indirect employment to an estimated six

men for every man directly employed in mining operations. As a consequence, the industry is the source of direct and indirect employment of about 12 percent of the entire Canadian work force. A decline in the level of mining activity would set in motion a sequence that would have a multiple effect on employment throughout the country.

Mining--A stimulant to national development

As a force for progress in Canada, the mining industry plays another unique role. It has spearheaded regional development, particularly in the North, where the last frontiers of Canada lie. Almost all of the permanent developments in this century in the Canadian north have resulted from mining enterprise and mineral discoveries. The names of such communities are legion and their numbers continue to grow, almost exclusively as a by-product of mineral endeavours. Given the economic base a successful mining enterprise provides, a community can take root and grow, developing service and manufacturing industries which give it substance and permanent. Without the economic nourishment of a resident, industrial enterprise, such communities simply would not come into being. Mining is, in fact, almost the only industrial activity that can function as a social and economic catalyst of this kind; no other means of northern development is readily available. As a consequence, any

condition which impedes the progress of mining automatically impedes also the development of new communities on our northern frontier. This could and would retard the kind of growth that Canada wants and needs.

We would like to illustrate this process with two examples from our own company's history. When work began in 1910 on the Hollinger mine, the Porcupine area, now the location of the town of Timmins, was literally in the Far North. It was accessible only by canoe. The country was a wilderness, lacking housing, transportation, power or any of the normal facilities of an effective community. All these things followed the establishment of the Hollinger and other mining companies in the area. Timmins and several other towns in the Porcupine area developed into enduring Canadian communities only because of the establishment of a mining industry.

This pattern was repeated at a later date in the development of the Quebec-Labrador Iron Trough. When our subsidiary company, Labrador Mining and Exploration Company Limited, began exploratory work in the Trough, in 1936, the country was indeed a wilderness. There was a small settlement at Sept-Iles but virtually no permanent settlements existed between the North Shore of the St. Lawrence and Ungava Bay. With our associates,

we pioneered this development, but it required 15 years' work and many millions of dollars to establish the existence of commercial grade ore in sufficient quantities to warrant the intensive development which began in 1950. Here again, transportation, communications, utilities, housing and other necessary facilities were established in a previously unsettled part of Canada. Other companies followed the trail blazed by our organization. Today Sept-Iles is no longer a riverside village but a busy city of more than 20,000 people. Several communities now thrive in the Quebec-Labrador Trough where none existed before. These communities represent milestones in the growth of Canada, made possible by an expanding mining industry.

These are but two isolated examples within our own company's history, but the pattern has been repeated by other mining organizations all across the northern areas of Canada. These communities represent measurable contributions to Canada's growth and development. Mines do, in fact, create national wealth. They also represent large new sources of tax revenues. To halt this progress by impeding the one industry capable of continuing it would be injurious to Canada and her future.

From these inherent characteristics alone, it is evident

that any disruption in the industry would be felt throughout the entire Canadian economy.

Largest producer of foreign exchange

There is another, important area of Canadian economics to which this industry makes a greater contribution than any other; this is its role as a producer of foreign exchange. In 1968 the export value of mineral products of approximately $3.7 billion was well above that of the great forest products industry. This is not an isolated instance. The mineral industry has been the country's largest producer of foreign exchange since 1957.

This record has not been achieved at the expense of Canada's secondary industry. The mineral industry is eager to have Canadian secondary industry developed. The advantages of home markets are obvious--but in the foreseeable future these markets will not be large enough to consume more than a substantial fraction of the minerals Canada is capable of producing.

MINING IS INTERNATIONAL

We have referred briefly to the international nature of development capital in the mining industry. Of equal significance are the international nature of markets and market prices for minerals and the accelerating capacity of many countries

to compete successfully in these markets Canada has developed. Because of the tremendous impetus it gives to a national economy, many countries have nourished their mineral-producing capacities to high levels. Many have done this recently--Australia, Peru, Chile, Brazil, and several African and Asian countries are relative newcomers to international mineral markets. Many others are eagerly seeking the development capital to enable them to compete.

With few exceptions, every mineral produced in Canada could be replaced today on international markets by minerals from other countries. Canada is richly endowed with minerals and mineral potential--but it would be a cardinal error to assume that Canada's mineral markets are secure. The Canadian industry has been able to develop and succeed in world markets only because of invigorating political, tax and industrial climates in Canada, not because of any monopoly or advantage in mineral deposits.

It is the contention of Hollinger that, as an employer, purchaser, developer of the North, and as a source of foreign exchange, the mineral industry has played a dominant role in the growth and economic progress of Canada. The industry can and should continue on this course by producing and selling products on world markets in spite of the increasing eagerness

and ability of many other countries to satisfy these markets to the detriment of Canadian trade. Canadians will be able to do this only if our tax legislation recognizes the unique characteristics of the industry, as they are recognized in most competitor countries.

A risk industry

The three-year tax free period now allowed to new mines gives logical recognition to the high risk involved in the mining industry. The first manifestation of this risk is in the exploration process and the costs related to it. On the basis of performance of the past five years; that is, the total cost devoted to exploration divided by the number of new mines that have come into production, the cost of finding each new mine is approximately $30 million. A comparable process in most other industrial operations would be that of locating a site for a new plant. Investigations of this nature can be carried out for a few thousand dollars, figures that are in no way comparable to the $30 million it costs to locate a new mine site.

This figure of $30 million represents only the cost of locating a new, commercial orebody. It does not include the heavy cost of putting the property into production. In the case

of our iron ore development in the Quebec-Labrador Trough, for example, the cost of placing these properties in production was more than ten times this $30 million figure.

Diminishing assets

In one other respect, the mining industry is essentially different from the usual industry. Every well-managed manufacturing or service industry has within it the capacity to grow and renew itself as its products or services succeed on the market. No such circumstances exist with respect to an orebody. Instead, a mine begins to diminish in size with the removal of the first ton of ore. The process continues throughout the entire working life of the orebody. Every ton of ore removed brings closer the day when the mine will be exhausted, hence the continuing need to search for new ore. The depletion allowance now granted to mines merely gives logical recognition to this economic fact which bears on this industry and this industry alone. Removal of the depletion allowance would inhibit the expenditures necessary to find new mines, deny the industry the necessary incentives for growth, and deny to the Canadian economy the far-reaching, beneficial effects generated by such growth.

Projections appended to this submission (Appendix 1) illustrate this point. They are based on a comparison of the

proposed tax structure as it would affect two enterprises of comparable size. One is a manufacturing enterprise. The other is a mine with a 20-year supply of ore. At the end of 20 years, each operation has paid about the same in taxes and dividends. The difference is that at the end of this period the manufacturing enterprise remains a going concern, its facilities and markets intact. The mining operation is out of business, its raw materials exhausted. This, we submit, is a discriminatory tax situation.

EFFECT ON INVESTORS

Canada's growth has been made possible by investments from within Canada and from abroad. It is quite apparent that the expansion of the Canadian mineral industry will continue to require the investment of foreign capital. As mentioned earlier, many other countries offer tax incentives to their mineral industries to compensate for the high risks involved. Sophisticated investors would quickly assess the change in philosophy represented by the withdrawal of these incentives in Canada. Their response would be normal, natural and inevitable. They would simply invest their money in countries where better risk investment opportunities exist. Such investment would largely be lost to Canada.

In this context, it should be recorded that Canadians also

invest heavily in our mining industry. In the absence of favourable circumstances in Canada, and being no less astute than people abroad, Canadian investors would divert mining funds to enterprises in other countries offering more incentives and more opportunities.

The authors of the White Paper apparently anticipated this possibility and proposed tax measures which can be interpreted as a deterrent to such a development. It is our opinion that these measures cannot be effective for this purpose. The combination of diluted incentives together with higher taxes on the industry will diminish the profitability of many mining enterprises to the extent that it will be economically advantageous for the Canadian investor--as well as to investors abroad--to invest in mining enterprises outside Canada.

Submitted with this brief as Appendix 2 is a comparison of two projected mining enterprises, one in the United States operating under existing, recently instituted tax laws there and one in Canada operating under the tax laws as proposed in the White Paper. This comparison demonstrates that in comparable mining situations, it would be advantageous for the Canadian to invest in an American mining enterprise rather than invest in a comparable Canadian enterprise. The implementation of the proposals of the White Paper would create a situation where

many countries with mineral potential would offer more advantageous conditions to the investor than Canada.

Such a situation would halt the flow of mining investment money into Canada and would, additionally, result in the flight of a large proportion of Canadian mining investment funds to other countries. The effect of this course of action on the Canadian economy would be most unfortunate and unnecessary.

Provincial taxes

Throughout this brief we have concentrated on the effect of the proposals of the White Paper with respect to federal taxation. There is another element that is inseparably linked to the profitability of Canadian mining enterprises--and that is the mining taxes levied by the provinces. These taxes vary from province to province but they constitute a levy on mining enterprises which is not borne in a proportionate manner by other industries. If the proposed tax structure of the White Paper is superimposed on these provincial structures, the profitability of mining enterprises will be reduced to such a degree that the Canadian industry will be unable to offer the quality of investment opportunity that will exist elsewhere.

HOLLINGER EXPERIENCE

Throughout this submission, we have maintained that expansion

of the Canadian mineral industry would contribute to the well-being of all Canadians. This can be demonstrated by our own history. Hollinger was the precursor organization in the development of iron ore mining enterprises in the Quebec-Labrador Trough. Hollinger is still associated as one of the large owners with the major producer in this area. The initial cost of this project was more than $500 million. In addition to the new jobs, new communities and new purchasing power it created, this enterprise sold more than $1.3 billion worth of products in foreign markets between 1955 and 1969. It can be stated categorically that, if the decisions of 1949-51 were being made today in the presence of the possible dilution of existing tax incentives, the project would not go forward.

For some time now a Hollinger subsidiary, Labrador Mining and Exploration Company Limited, has made plans and entertained hopes for possible development of a new iron ore mining operation in this area. The property includes more than 500,000,000 tons of ore. It could support an operation producing 5,000,000 tons of iron concentrate per year for a period of more than 40 years, thus creating an economic unit of far-reaching significance to the Canadian economy. Under favourable circumstances, products from this property could be competitive with United States taconite. Without existing incentives, they cannot compete economically.

The plans and hopes for this property would be rendered meaningless and Canada would be denied this specific opportunity for expansion of its resources by the proposed modification of existing tax incentives, particularly the depletion allowance.

Other major expansions are being considered by our associated company, Iron Ore Company of Canada. These considerations--and the possibility of expansion they embrace--will be postponed indefinitely if the White Paper proposals are enacted into law.

The examples mentioned here are typical of many mining opportunities that could be lost to Canada through the introduction of a faulty tax structure. From our own experience and from observation of others, we cannot escape the conclusion that withdrawal or dilution of the existing system of mining tax incentives would inhibit the growth of the mineral industry and, consequently, of Canada.

Effect on Hollinger

For more than half a century Hollinger has devoted its energies and funds to the development of the mining industry in Canada, and we are deeply distressed by the possibility that a tax structure, which will do irreparable injury to the industry, may be introduced. The proposals of the White Paper, if enacted

into law will, on the basis of our calculations, do injury to the industry and to the growth prospects of the country.

Hollinger is but one of many hundreds of operating mining companies in Canada and the effect these proposals would have on Hollinger will be felt in a proportionate manner by all operating members of the mining community. In one aspect, its association with the Iron Ore Company of Canada, Hollinger is in an unusual situation with respect to the effect of the proposed tax structure. This situation is dealt with in Appendix 3. In most respects. its position is similar to that of other members of the mining community and our calculations indicate that the proposed tax structure would reduce the profitability of the Hollinger operation by approximately 25 per cent. Extend this or a similar calculation to the spectrum of mining operations in Canada and the effect is simply to destroy the vitality of the industry--to convert a healthy, growing industry into an ill and declining industry.

Recommendations

> In view of the fact that the present tax structure and political climate has made possible the development of an industry that is a tremendous asset to the economic well-being of the country

In view of the fact that under the present tax structure the industry exhibits the capability of massive growth, with a corresponding and automatic ability to generate tax revenues based on this growth

In view of the fact that the proposed tax structure will impede the growth of the industry and ultimately decrease its value as a source of tax revenue

It is our recommendation that the tax structure as it applies to the mining industry remain unchanged.

Hollinger Mines Limited

APPENDICES

Appendix 1

These calculations demonstrate that the effect of the White Paper proposals on a mining enterprise would be more severe than on a comparable manufacturing operation.

Schedule 1 compares over a period of twenty years (a) the position of a company deriving its income from a mine, oil or gas well (Extracting company) with that of a company deriving its income from other sources such as manufacturing (Ordinary company) and (b) the earnings retained by a shareholder in the companies both under the following conditions:

(1) Capital issued was similar.

(2) $7,500 was spent on exploration and development expenses and fixed assets at the mine in the case of the Extracting company and a like amount on fixed assets having an average capital cost allowance rate of 15% in the case of the Ordinary company.

(3) Income before deduction of allowances for expenditures described in (2) above amounted to $1,500 annually.

(4) Allowances charged in the accounts except depletion were the same as those claimed for tax purposes.

(5) Cash remaining excluding that arising from the capital cost and other allowances except depletion was distributed to the shareholders.

The comparison shows that in the case of the company

(a) the amount expended by the Extracting company on exploration and development expenses and fixed assets had been fully recovered out of pre-taxed earnings and the amount expended by the Ordinary company on fixed assets had also been recovered (96%) out of its pre-taxed earnings and these amounts could be returned to the shareholders.

(b) Profits after taxes amounted to $10,000 in the Extracting company as compared to $11,397 in the Ordinary company.

(c) $2,500 arising from depletion remained available for distribution to the shareholders of the Extracting company.

(d) The taxable amount available for distribution to share-holders was $12,500 in the case of the Extracting company and $11,397 in that of the ordinary company,

and shows that in the case of the individual shareholders, there is little difference in the final amount of retained earnings. In the case of a shareholder taxable at a rate of 50%, the amount retained would be $8,750 in the case of the Extracting company and $8,548 in that of the Ordinary company. The difference is only $202 in favour of the Extracting industry and it should be noted that in the cases of taxpayers taxable at 30% and 40%, this favourable margin is $283 and $242 respectively.

Provincial mining taxes, which vary in each province, and reach 15% on mining income in some provinces, would be assessed in addition to the tax shown on the schedule.

The final effect is that the manufacturer is still in business, his facilities, markets and raw material sources intact and capable of continued operations, while the mining operation, with its ore exhausted, is out of business.

Schedule 1

COMPARATIVE ANALYSIS

EXTRACTING COMPANY VS ORDINARY COMPANY

	Extracting company					Ordinary company				
	1-5 years $	5-10 $	10-15 $	15-20 $	Total $	1-5 years $	5-10 $	10-15 $	15-20 $	Total $
Operating Profits $1,500 p.a.	7,500	7,500	7,500	7,500	30,000	7,500	7,500	7,500	7,500	30,000
Less:										
CCA (depreciation)	1,500	-	-	-	1,500	4,173	1,851	816	367	7,207
Exploration and Development	6,000	-	-	-	6,000					
					22,500					
Depletion 1/3 of Exploration & Development and CCA	-	2,500	-	-	2,500	-	-	-	-	-
Taxable income	-	5,000	7,500	7,500	20,000	3,327	5,649	6,684	7,133	22,793
Tax at 50%	-	2,500	3,750	3,750	10,000	1,663	2,825	3,342	3,566	11,396
Profit after income tax	-	2,500	3,750	3,750	10,000	1,664	2,824	3,342	3,567	11,397
Available for distribution to shareholders										
Profit after income tax	-	2,500	3,750	3,750	10,000	1,664	2,824	3,342	3,567	11,397
Depletion	-	2,500	-	-	2,500	-	-	-	-	-
Dividends	-	5,000	3,750	3,750	12,500	1,664	2,824	3,342	3,567	11,397
Shareholder										
Taxable income (dividends as above)					12,500					11,397
Taxable credit					5,000					5,698
					17,500					17,095
Tax at 50%					8,750					8,547
Creditable Tax					5,000					5,698
					3,750					2,849
Retained by shareholder										
Dividend received					12,500					11,397
Personal income tax					3,750					2,849
					8,750					8,548

Appendix 2

These calculations indicate how the enactment of the White Paper proposals for tax reform would defeat the ability of a Canadian mining enterprise to offer mining investment opportunities that would be as attractive as those available elsewhere. For comparison we have used a Canadian and a United States situation, but comparable situations exist in many countries.

Schedule 2 compares over a period of twenty years the position of a company deriving its income from a mine producing iron ore under the proposed provisions of the White Paper with that of a company under the recently enacted provisions of the Internal Revenue Code in the United States under the following conditions:

(1) Capital issued was similar.

(2) $7,500 was spent, $1,000 on exploration expenses, $5,000 on development expenses and $1,500 on fixed assets at the mine.

(3) Income before deduction of allowances for expenditures described in (2) above amounted to $1,500 annually.

(4) Allowances charged in the accounts except depletion were the same as those claimed for tax purposes. In the case of the U.S. company, the actual amount expended for exploration expenses was written off in the accounts ($1,000) while depletion of $11,750 was claimed for tax purposes.

It will be observed in this schedule that, from the point

of view of the investor, the United States investment is much more attractive than the Canadian investment. In relation to the total available for distribution to shareholders at the end of 20 years, the advantage offered by the U.S. company is 32 per cent.

Schedule 2

COMPARATIVE ANALYSIS OF EXTRACTING COMPANIES

	Canada - After The White Paper					U.S. - After 1969 Tax Reform				
	YEARS					YEARS				
	1-5 $	5-10 $	10-15 $	15-20 $	Total $	1-5 $	5-10 $	10-15 $	15-20 $	Total $
Operating Profits $1,500 p.a.	7,500	7,500	7,500	7,500	30,000	7,500	7,500	7,500	7,500	30,000
Less:										
Depreciation (CCA)	1,500				1,500	750	750			1,500
Exploration cost	1,000				1,000					
Development cost	5,000				5,000	5,000				5,000
	7,500	-	-	-	7,500	5,750	750	-	-	6,500
Income before depletion	-	7,500	7,500	7,500	22,500	1,750	6,750	7,500	7,500	23,500
Depletion:										
Canada - 1/3 of above cost	-	2,500	-	-	2,500					
U.S. - 15% of gross income not exceeding 50% of income						875	3,375	3,750	3,750	11,750
Taxable income	-	5,000	7,500	7,500	20,000	875	3,375	3,750	3,750	11,750
Tax at 50%	-	2,500	3,750	3,750	10,000	438	1,687	1,875	1,875	5,875
PROFIT AFTER TAX	-	2,500	3,750	3,750	10,000	437	1,688	1,875	1,875	5,875
Available for distribution to shareholders										
Profit after tax	-	2,500	3,750	3,750	10,000	437	1,688	1,875	1,875	5,875
Depletion	-	2,500	-	-	2,500	875	3,375	3,750	3,750	11,750
Less: Exploration cost written off	-	-	-	-	-	(1,000)	-	-	-	(1,000)
TOTAL	-	5,000	3,750	3,750	12,500	312	5,063	5,625	5,625	16,625

Appendix 3

This memorandum, together with covering letter, deals with the relation of Hollinger and its subsidiaries to the Iron Ore Company of Canada and the implications of reversing a previous government decision and treating this company as a foreign corporation for taxation purposes.

This matter has already been presented to the Minister of Finance as indicated in the letter and the memorandum. It is included with this brief to emphasize the fact that unless adequate measures are taken to treat this matter as a special case, the enactment of the proposals of the White Paper into law would lead to a massive reduction in after-tax earnings for Hollinger. This is brought out clearly in the memorandum attached hereto.

HOLLINGER MINES LIMITED

OFFICE OF THE PRESIDENT
SUITE 601 — 1155 DORCHESTER BLVD. WEST.
MONTREAL 2, QUEBEC — TEL.((514) 866-5081

A. L. FAIRLEY, JR.
PRESIDENT

December 5th, 1969.

Honourable E.J. Benson,
Minister of Finance,
Ottawa, Canada.

Dear Mr. Minister,

I am attaching hereto a Memorandum setting forth the historical development, and the present situation, with respect to the Federal taxation regulations as they apply to the Iron Ore Company of Canada.

As you will note from reading this Memorandum, the Iron Ore Company of Canada is an American Corporation, having been incorporated in Delaware in 1949, but has been treated from 1949 up until the present as a Canadian corporation for taxation purposes. The Iron Ore Company of Canada does business only in Canada and all of its income, including interest earned in the United States, is subject to Canadian taxation, just as if it was a Canadian corporation. Likewise, the dividends which Iron Ore Company pays to Hollinger Mines and Labrador Mining and Exploration Company have always been considered as dividends from one Canadian corporation to another and, consequently, not subject to taxation.

The above arrangements were worked out in complete detail between the Company and both the American and Canadian Governments at the time of incorporation.

Honourable E.J. Benson. December 5th, 1969.

If the recommendations of the White Paper are carried into law, it would mean that these dividends from Iron Ore Company to Hollinger and Labrador would be taxed at a full 50% rate, thus cutting Hollinger and Labrador income, from this source, in half.

In view of the fact that the Iron Ore Company of Canada is unique and that both the Canadian and American Governments were parties to the original arrangements, it is requested that, in any new legislation brought before the House, you will provide relief from the application of the tax changes which are proposed in the White Paper.

Yours very truly,

A.L. Fairley, Jr.

ALF:mbh
Attachment.

MEMORANDUM

Re: HOLLINGER MINES LIMITED and its subsidiaries
LABRADOR MINING AND EXPLORATION COMPANY LIMITED
and HOLLINGER NORTH SHORE EXPLORATION COMPANY,
LIMITED (No Personal Liability)

Re: Foreign Corporations operating in Canada

In the White Paper on Proposals for Tax Reform as delivered by The Honourable E.J. Benson, Minister of Finance, on the 7th of November, 1969, Articles 4.66 and 4.67, page 57, deal with "Foreign Corporations Operating in Canada", as follows:-

> "4.66 The present dividend tax credit applies to dividends received from taxable Canadian corporations. This phrase can cover all corporations resident in Canada whether or not they are incorporated under Canadian laws. As part of its program to improve the effectiveness of the tax system, the government proposes to remove some of the distinctions now made between corporations on the basis of residence and to distinguish instead on the basis of the place of incorporation. (It is possible for foreign corporations to move out of Canadian jurisdiction entirely. This type of manoeuvre is not open to corporations created under Canadian law.) Under the new proposals, the system of credits for corporate tax would apply only to corporations incorporated in Canada.
>
> 4.67 This provision could mean a substantial change to some foreign corporations which now are resident in Canada and whose dividends now qualify for the dividend tax credit. Consequently it is proposed that dividends from these corporations be treated the same as dividends from Canadian corporations for a temporary period of five years in order to give them time to rearrange their affairs to conform with the new tax laws."

Hollinger Mines Limited ("Hollinger Mines") is a

mining company incorporated under the laws of the Province of Ontario, having its head office in the Town of Timmins, Ontario. Its gold mining operations in Timmins were discontinued in the early part of 1968, after being in operation for over 55 years. As at December 31, 1968, Hollinger Mines had 6,552 shareholders, of which 5,216 (80%) were residents of Canada holding in all approximately 85% of the issued shares of the Company.

Labrador Mining and Exploration Company Limited ("Labrador Mining ") is a mining company incorporated under the laws of the Province of Newfoundland, having its registered office at the City of St. John's, Newfoundland. As at December 31, 1968, Labrador Mining had 3,111 members (shareholders), of which 2,489 (80%) were residents of Canada holding in all approximately 74% of the issued shares of the Company.

Hollinger North Shore Exploration Company, Limited (N.P.L.) ("North Shore") is a mining company incorporated under the laws of the Province of Quebec, having its head office in the City of Montreal, Quebec.

Hollinger Mines owns 58.384% of the issued shares of Labrador Mining and 60% of the issued shares of North Shore.

In 1941 the Directors of Hollinger Mines decided to

do exploration work in Labrador (Province of Newfoundland) and in the Province of Quebec. In order to carry out this work in Labrador, Hollinger Mines acquired a controlling interest in Labrador Mining. In 1942 Hollinger Mines caused North Shore to be formed for the purpose of facilitating exploration work in the Ungava Area, or New Quebec as it is frequently called. Labrador Mining and North Shore had originally gone into these areas to search for base metals other than iron ore, but soon realized that it was iron ore country.

Neither Labrador Mining nor North Shore at that time had any funds. Labrador Mining was, in a great measure, financed by acquisitions of shares of its capital stock by Hollinger Mines. In the early 1940's the Hanna Mining interests of Cleveland acquired a minority interest in Labrador Mining which, at the present time, stands at 22.3%. The funds in North Shore were advanced 60% by Hollinger Mines and 40% by Hanna. The Hanna Mining interest were brought into this new project in Labrador and New Quebec primarily because of their experience in the iron ore business (Hollinger Mines' previous experience had been primarily in gold mining).

Exploration and development work has been carried on continuously by Labrador Mining and North Shore from 1942 to date.

The advice Hollinger Mines received in the 1940's was that it would be useless to attempt to finance an iron ore mining operation more than 300 miles north of the Gulf of St. Lawrence (the port of entry being Sept Iles) unless these companies could prove up in excess of 300 Million tons of open pit, high grade, direct shipping ore. This objective was accomplished in the latter part of 1949 after expenditures on exploration and development work by Labrador Mining and North Shore aggregating in excess of $3.5 Million to that date.

The Hanna officials, who, as mentioned above were experienced in the iron ore business, were extremely sceptical about being able to finance an operation. However, during the war the high grade ore reserves in the State of Minnesota had been greatly depleted and the large steel companies in the U.S.A. were searching for other iron ore reserves, and this was one factor that made it possible to arrange financing for the project. Other factors at that time were the favourable tax climate in Canada both at Federal and Provincial levels (as compared to the then Minnesota tax laws) and Canadian political stability.

In order to finance the plan it was necessary to obtain sales contracts for iron ore for a 25-year period. These

contracts were eventually arranged with the six large U.S. steel companies hereinafter mentioned. Consideration was given to forming a company in which the six steel companies who were to enter into the 25-year contracts would be shareholders. It was also planned that the Hanna interests, Hollinger Mines, Labrador Mining and North Shore would be shareholders. The Hanna Mining Company also entered into 25-year contracts to purchase iron ore.

In November of 1949 the plan culminated in the incorporation of Iron Ore Company of Canada ("IOCC") under the laws of the State of Delaware, U.S.A., and the sub-leasing to IOCC by Labrador Mining and North Shore of what, for practical purposes, may be stated to be two-thirds of the iron ore in certain portions of the concessions held by Labrador Mining and North Shore. The purpose of IOCC was to produce and sell the iron ore so sub-leased to it. The capital stock of IOCC is now owned as follows:-

Hollinger Mines	11.64%
Labrador Mining	5.42%
Total Canadian Ownership -	17.06%
The Hanna Mining Company	26.85%
National Steel Corporation	16.83%
Republic Steel Corporation	5.61%
Armco Steel Corporation	5.61%

Youngstown Sheet and Tube Company	5.61%
Wheeling-Pittsburgh Steel Corporation	4.48%
Bethlehem Steel Corporation	17.95%
Total U.S. Ownership -	82.94%

The participation of U.S. steel companies in the enterprise followed the accepted pattern in the U.S.A. and Canada (and now in Europe) where it had long been the practice for steel consumers to participate in the ownership of ore producing companies.

IOCC carries on <u>all</u> of its operations in Canada and initially expended in excess of $250 Million on mining, milling, transportation, terminal and electric power facilities. The total investment in the iron ore project by IOCC and, more latterly, the Carol Pellet Company (in which last mentioned company Hollinger Mines and Labrador Mining have no financial interest) as at December 31, 1968, was as follows:

(Dollars in Thousands)

	U.S. Bondholders	Canadian Shareholders	U.S. Shareholders	Total
Iron Ore Company of Canada				
Cash Investment				
Stock		$14,750	$ 95,250	$110,000
Debentures		8,400	84,270	92,670
Bonds	$145,000			145,000
	$145,000	$23,150	$179,520	$347,670
Stock Issued for exploration and option rights		5,000		5,000
Total IOCC	$145,000	$28,150	$179,520	$352,670
Reinvested earnings				158,200
Total Invested in Project				$510,870
Carol Pellet Company				
Stockholders stock and notes			$ 23,616	
Insurance Company loans			56,200	
Bank loans			31,840	111,656
Total Project				$622,526

The financing of this project would not have been possible without the participation of the U.S. Companies both as shareholders, bondholders and as consumers, and there was nothing the Hollinger interests could have done except to go along with the idea of incorporating a U.S. company and having same financed as set

out above. The only alternative would have been to put the entire project in mothballs.

As it has turned out, if the project had not proceeded in the early 1950's, it is doubtful if it ever would have gone ahead, because during that period and thereafter there was a great change in the iron ore business - ways and means were found to utilize low grade iron ores from the numerous reserves of such ores in the U.S.A. (primarily in the State of Minnesota) and major deposits were found in South America, Africa and more recently in Australia.

The utilization of low grade iron ores in Minnesota was further facilitated by that State enacting, in 1964, legislation freezing mining taxes for a period of 25 years.

To illustrate the impact of these changes, it should be noted that while Labrador Mining and North Shore were at one time able to sell substantial tonnages from the one-third of the iron ore reserved to them under the aforementioned Sub-leases, these sales occurred during the period 1955 to 1963, and since 1963 neither Company has been able to sell any of its own iron ore, despite vigorous efforts to that end.

We wish to stress and give particular emphasis in this Memorandum to the fact that, at the time of the organization

of IOCC, serious consideration was given to the formation of a Canadian corporation. It was, however, decided that the formation of a U.S. corporation would provide certain tax advantages in the U.S.A. to certain of the U.S. shareholders without in any way affecting IOCC's tax liability in Canada or the tax liability of its Canadian shareholders. In fact not only was consideration given to forming IOCC as a Canadian corporation but it was definitely planned that this should be done, which plans had to be discarded because the required capital could not be raised unless the U.S. participants could be given the tax benefits to which they would be entitled if IOCC were a U.S. Corporation, and these benefits would not be available if the company were a Canadian corporation. Moreover, in order to ensure that there would be no questions arise under the Canadian Income Tax Act in regard to the taxation of the profits of IOCC when distributed as dividends to the Canadian participants, namely, Hollinger Mines, Labrador Mining and North Shore, it was agreed that if a U.S. company were formed then all its profits including not only profits from the operations in Canada but also any profits received from investments in the U.S.A. should be reported for taxation in Canada and this has been done.

To clarify the foregoing, at the time of the negotiations if IOCC were a Canadian company -

(a) all its profits would have been subject to regular Canadian income taxes,

(b) the profits when distributed as dividends to the U.S. participants would have been subject to Canadian 15% non-resident tax,

(c) the profits when received as dividends by the U.S. participants would have been subject to U.S. income taxes on the whole amount thereof (38% at that time), and

(d) the profits when received as dividends by the Canadian participants would have been treated as dividends paid by one taxable Canadian corporation to another;

whereas if IOCC were a U.S. company and all its profits were brought into Canada for taxation, which was the ultimate arrangement -

(a) all its profits would have been subject to regular Canadian income taxes,

(b) its profits when distributed as dividends to the U.S. participants would have been subject to the Canadian 15% non-resident tax and when received by the Canadian participants as dividends would not have been subject to any non-resident taxes,

(c) the profits when received as dividends by the U.S. participants would have been subject to U.S. taxes (38% at that time) but only on 15% of the amount of the dividends received, and

(d) the profits when received as dividends by the Canadian participants would have been treated as dividends paid by one taxable Canadian corporation to another.

The foregoing very brief summary demonstrates the

differences in tax imposed by Canada and the U.S.A. at the time of the negotiations which had to be taken into account in determining whether IOCC should be a Canadian corporation or a U.S. corporation, but even the benefit to the U.S. participants of having a U.S. corporation on the basis above indicated was not sufficient and they insisted that it should be a condition of their contributing the necessary capital (and it is again stressed that it was virtually impossible at that time to raise the necessary capital in Canada) that IOCC should not only be an American corporation but that it should also be clearly established that any dividends received by the U.S. participants as a result of the operations <u>would not be subject to any Canadian non-resident tax</u>. There was full consultation between the Canadian and the U.S. Governments during the period of corporate planning for IOCC and in this connection attention is called to Article XII (2) of The Canada - U.S. Reciprocal Tax Convention. This provision was inserted in the Convention in its present form as a result of the negotiations between the parties and the consultations between the two Governments to ensure that the U.S. participants in IOCC would not be subjected to any Canadian non-resident tax on dividends received by them as a result of the operation and was understood

by the parties virtually to be an agreement by the Canadian Government to this effect and one without which the American participants would not have been prepared to contribute the required capital. We wish to emphasize that the Canadian Government at that time agreed to the changes in the Reciprocal Tax Convention to make the deal possible and the shareholders of IOCC would certainly take a dim view of any legislation that would abrogate the arrangements entered into at that time.

It is to be stressed that the operations in Canada of IOCC differ widely from the ordinary foreign corporation operating in Canada to make additional profits from its Canadian operations for its foreign shareholders. IOCC carried on all its operations in Canada and all its income including income from U.S. investments is taxed in accordance with the taxation laws of Canada, whereas in the case of an ordinary foreign corporation operating in Canada only the income from the Canadian operations is subjected to Canadian income tax.

Clause 4.52 of the White Paper recognises that corporation tax could be collected twice, three times or even more often from the same profits if it were not for the present exemption from tax of dividends received by one Canadian corporation. Clause 4.54 refers to the fact that present legislation makes the dividend tax credit available to shareholders

of corporations "even though the profits are either entirely or almost entirely earned abroad and have not been subjected to Canadian corporate tax", and Clause 4.55 states that "the government proposes to restrict the credit to shareholders of Canadian corporations by reference to the Canadian corporate tax actually paid by their corporations".

Clause 4.66 (the full text of which is set forth at the beginning of this Memorandum) then puts forward a new distinction between corporations the dividends of which would qualify for tax credits in the hands of a Canadian tax paying recipient corporation. While heretofore the credit has been available if the paying corporation was a resident of Canada (and hence subject to payment of Canadian corporation income tax) it is now proposed that the tax credit would not be available unless the paying corporation is in fact incorporated in Canada, regardless of where it carries on its business. If we understand this proposal correctly, the result would be that dividends paid by IOCC to its Canadian corporate shareholders (Hollinger Mines and Labrador Mining) would not qualify for tax credits, notwithstanding the fact that IOCC carries on all its operation in Canada and is itself subject to Canadian Corporation tax in respect of all such operations. As an indication of

the consequences of this proposal, if it had been in effect in 1968 the dividend of $4 Million (Canadian Funds) received by Hollinger Mines in that year from IOCC would have been reduced to $2 Million after corporation tax, and the dividend of $1.8 Million (Canadian Funds) received by Labrador Mining in that year would have been reduced to $900,000 after corporation tax.. From these examples it will readily be appreciated that the changes proposed by Clause 4.66 will have a drastic and most adverse effect on the Canadian shareholders of IOCC viz: Hollinger Mines and Labrador Mining and the Canadian shareholders of those Companies, who will be severly penalized by reason of the fact that IOCC is a U.S. corporation. For the reasons set forth in detail above the Canadian participants in IOCC could not have arranged for its incorporation in Canada at the time of its formation and those reasons were accepted as valid by the Government of Canada at that time. Because of their minority position in IOCC Hollinger Mines and Labrador Mining will be unable to bring about any change in the corporate status of IOCC as suggested in Clause 4.67 of the White Paper.

In view of the unique character of IOCC and the special circumstances surrounding its formation it is submitted that it would be equitable to provide relief from the application

of the tax changes proposed by Clause 4.66 of the White Paper.

We have not attempted in this Memorandum to deal with the proposals contained in the White Paper relating to depletion allowances, the 3-year exemption for new mines and other matters which, also, if implemented, would have disastrous consequences for Hollinger Mines, its subsidiaries and shareholders. It is proposed to cover these features in future submissions.

APPENDIX "B"

NAME: HOLLINGER MINES LIMITED

SUBJECT: Three Year Tax Exemption
Depletion

Analysis of Appendix "A" by Senior Advisor

This Brief is submitted by Hollinger Mines Limited. This is a public company, incorporated in 1910, and owned by some 6,500 shareholders, of whom about 80% are residents of Canada. The company commenced operations with a silver mine in Ontario, which finally ceased operations in 1968 after 57 years of production. The main operation of the company at the present time is iron ore mining.

The Brief deals exclusively with the effects upon the mining industry if the present laws are changed with respect to:

(1) Depletion

(2) The three year tax exemption granted mines coming into commercial production.

The attention of the Committee is drawn to the following points made in the Brief:

(1) The high cost of discovering an ore body and the wasting nature of the ore body once it is discovered, developed and mined. (Page 6 of the Brief)

(2) The international nature of the industry with respect to risk and development capital. (Page 6 of the Brief)

(3) The international nature of mineral markets and mineral prices. (Page 6 of the Brief)

(4) The present provisions (three year tax exemption and depletion) represent tax incentives of proven value to the industry. (Page 7 of the Brief)

(5) The belief that the proposed substitutes for these incentives are not realistic or useful. (Page 7 of the Brief)

(6) That the exchange of the present incentives for retrogressive provisions would result in a curtailment of operations in the industry. (Page 9 of the Brief)

(7) Since the era of railway building, the mineral industry has been the greatest single force in Canada leading to the development of new regions. (Page 9 of the Brief)

(8) The Canadian mineral industry provides Canada with about 30% of its foreign exchange. (Page 9 of the Brief)

(9) The implementation of the proposals of the White Paper would discourage investment capital from Canada and abroad. (Page 9 of the Brief)

(10) The mining industry gives direct employment to 150,000 people and indirect employment, it is estimated, to 900,000 people, or a total of about 12% of the entire Canadian working force. (Pages 10 and 11 of the Brief)

(11) That with few exceptions, minerals presently produced in Canada can be replaced on international markets by minerals mined elsewhere. (Page 15 of the Brief)

(12) Removal of the depletion allowance would inhibit expenditures exploring for new mines. (Page 17 of the Brief)

(13) The combination of diluted incentives, together with higher taxes on the industry will diminish the profitability of many Canadian marginal mining ventures. As a result it will be economically advantageous for the Canadian investor - as well as non-resident investors - to invest in mining enterprises outside Canada. (Page 19 of the Brief)

(14) Had the White Paper proposals been in effect in 1949 to 1951, the company would undoubtedly have decided not to proceed with the development in the Quebec Labrador Trough. (Page 21 of the Brief)

(15) That present major expansions now being considered will be postponed indefinitely if the White Paper proposals are enacted as law. (Page 22 of the Brief)

(16) The proposals of the White Paper, if enacted as law, will do injury to the industry and to the growth prospects of Canada. (Pages 22 and 23 of the Brief)

(17) The proposed tax structure would reduce the profitability of the Hollinger operation by approximately 25%. (Page 23 of the Brief)

The Brief states:

(1) That the present tax structure and political climate has made possible the development of an industry that is a tremendous asset to the economic well-being of the country.

(2) The mining industry has exhibited the capability of massive growth under the present tax structure.

(3) The proposed tax structure will impede the growth of the industry.

Accordingly the Brief recommends that the tax structure as it applies to the mining industry remain unchanged.

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: HOLLINGER MINES LIMITED

Date Brief Received:

Principal Subject: Three Year Tax Holiday

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83-5 of the Income Tax Act This section provides that income for three years after commencing operation of a mine is exempt from tax.	5.31 Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines. 5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.	Page 16 of the Brief The brief points out that the three year tax-free period now allowed to new mines gives logical recognition to the high risk involved in the mining industry. Page 7 of the Brief The brief states: "These present provisions represent tax incentives of proven value to the industry. They are, of course, no more liberal than the tax incentives offered by competitive mineral-producing countries around the world. But they have been sufficiently effective to amount to a first-class national investment. We do not believe the proposed substitutes for these considerations to be realistic or useful."

Name: HOLLINGER MINES LIMITED

Date Brief Received:

Principal Subject: Depletion - Operator

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Part 12 - Section 1201 of the Income Tax Regulations This section provides for a 33-1/3% depletion allowance based upon net profit from the operation of the resource.	5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is 33⅓ per cent. Special rates of depletion are provided for gold and for coal.	Page 17 of the Brief Every well-managed manufacturing or service industry has within it the capacity to grow and renew itself as its products or services succeed on the market. No such circumstances exist with respect to an ore body. The depletion allowance now granted to mines merely gives logical recognition to this economic fact.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:	

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

APPENDIX "C"

SUBMISSION BY

SYNCRUDE CANADA LTD.

TO

THE SENATE

STANDING COMMITTEE ON

BANKING, TRADE AND COMMERCE

WITH RESPECT TO

PROPOSALS FOR TAX REFORM

Submitted on behalf of the shareholders:

Atlantic Richfield Canada Ltd.
Cities Service Athabasca, Inc.
Imperial Oil Limited
Gulf Oil Canada Limited

March 1970

TABLE OF CONTENTS

SUMMARY OF SUBMISSION

1. The Athabasca tar sands in northern Alberta contain over 286 billion barrels of recoverable reserves of synthetic crude oil equivalent, which is of the same order of magnitude as those of the famed Middle East, or about twenty-eight times the total amount of remaining proved recoverable reserves of conventional oil in Canada. The tar sands are unlike any other resource in Canada and for years have resisted numerous attempts to extract the oil economically from the sand.

2. The demand for oil in the U.S.A. is expected to outstrip domestic supply (including Alaska) by approximately 4.5 million barrels per day by 1975 and by 6 million barrels per day by 1980. Canada has an excellent chance to supply a greater part of this market by developing the Athabasca tar sands.

3. Syncrude has developed a process through the pilot plant stage and proposes an immense project to cost over $200 million to produce oil from the sands. This is a high risk undertaking involving new technology and costs must be such as to permit the end products to compete in the established market for petroleum. The proposed investment is marginal under the most realistic assumptions and the operating risk factor is sufficiently large that despite the approximately $30 million spent to date to develop the process, a final decision to proceed with the basic plant investment will not be made for a further three years, depending upon the assessment at that time of a number of variables. Syncrude has a permit from the Alberta Oil and Gas Conservation Board to start production but not before 1976.

4. Elimination of the three-year mining tax exemption and the drastic reduction of the depletion allowance proposed in the White Paper will almost certainly kill the project.

5. The White Paper proposes sharply reduced fiscal incentives to the Canadian oil industry without differentiating between conventional and synthetic crude production (tar sands). By contrast, the U.S. Government in 1969 increased the depletion allowance available to taxpayers producing synthetic crude by mining oil shale while at the same time reducing the depletion allowances available for all conventional oil operations.

6. If this project goes ahead, Canada will gain by:

(a) The local economic benefits in an impoverished remote area of a $200 million oil plant, together with a $50 million - $100 million electrical utility development.

(b) Favorable continuing impact on regional economy - the Syncrude project alone will create 6,000 - 8,000 jobs in Alberta when the plant is in operation.

(c) Direct tax revenues (33-1/3% taxation of a new source of income better benefits the Treasury than 50% taxation of nothing).

(d) Tax revenues that will be generated indirectly from employment and services for the construction and operation of the plant.

(e) Royalty revenues to Alberta.

(f) Other tar sands plants and satellite industries that will follow Syncrude's success.

7. Syncrude Canada Ltd. submits that the public interest in the development of the Athabasca resource requires retention of the three-year mining exemption and present depletion allowance - not alone for Syncrude but for the development of the Athabasca tar sands. If the present law regarding the three-year mining exemption and percentage depletion allowance is to be changed for conventional mining and oil operation, an exception should be made for processes producing oil from the Athabasca tar sands, which, as noted, is a resource unlike anything else in Canada.

INTRODUCTION

Syncrude Canada Ltd. is a management company formed to develop production of crude oil from the Athabasca tar sands in Northern Alberta. Direct participating interests in the project and rights are owned as to 10% by Gulf Oil Canada Limited and as to 30% each by Imperial Oil Limited, Cities Service Athabasca, Inc., and Atlantic Richfield Canada Ltd.

Detail on the history, development and present status of the Syncrude project is set forth in the attached Appendix I.

The participants have spent to date $30 million in research and development on this project. They have developed a process for recovery of commercial grade oil from the tar sands that is significantly different from that employed by Great Canadian Oil Sands Limited which operates the only existing plant processing tar sands. In September 1969 the Alberta Oil and Gas Conservation Board granted Syncrude a permit, applied for in 1962 by the participants, to construct a major plant for production of synthetic crude and specialty oils from the tar sands. After seven years of postponement, contestation and further hearings, the way was thus opened for the project to proceed. The plant is projected to involve an investment of approximately $200 million. An additional $50 million to $100 million will be required for an electric generating plant to supply the needs of Syncrude's project plus other provincial requirements. Accordingly, negotiations are underway with Canadian Utilities Limited on the basis of a 100 megawatt base load for the Syncrude project with additional capacity to feed into the Alberta provincial power grid. In total, the generating capacity of the plant would be approximately equivalent in size to one supplying a city of over 200,000 population.

Syncrude's permit provides for the production commencement date to be not before July 1976. The project schedule is set forth on the flow sheet produced as Appendix II.

THE ATHABASCA TAR SANDS

There are over 286 billion barrels of upgraded synthetic crude oil equivalent in the Athabasca tar sands or about twenty-eight times the total amount of remaining proved recoverable reserves of conventional oil in Canada.

The Athabasca tar sands consist of oil-saturated sand that occurs both at the surface and under varying depths of overburden. The deposit comprises grains of water wet sand each of which is coated with a thin film of bitumen, interspersed with layers of clay and siltstone. In the production of oil, near surface extraction operations of the type practiced by Great Canadian Oil Sands and proposed by Syncrude Canada Ltd. bear no similarity to conventional oil wells but instead utilize large open pit mining methods involving huge earth-moving machines, conveyor belts and other bulk handling equipment.

RISK IN TAR SANDS DEVELOPMENT

Although the tar sands have been known for almost two hundred years, and despite the concentrated effort to achieve commercial oil extraction during the past twenty years, the risks and technical difficulties involved in tar sands production still exist and are affirmed by the very small number of companies that have shown a serious interest in the area. As noted in Appendix I, various government and industry sponsored attempts over the years have been abandoned and only one plant (owned by Great Canadian Oil Sands) is in operation today. Shell Canada Limited recently abandoned its application before the Alberta Oil and Gas Conservation Board for a permit to produce from the tar sands and the only other serious applicant for such a permit, Amoco Canada Petroleum Company Ltd., requested deferral of its application in April 1969 while a decision of the Oil and Gas Conservation Board was pending.

At the present time there is no indication that any private or public investor other than Syncrude is willing to undertake a tar sands venture. There is good reason for the lack of interest.

To date, the first commercial tar sands venture has operated at a great loss. The newness of the operation, the innovation at several points due to the nature of the raw material, and the remote location have all contributed to this result, which attests to the substantial risk factor present in any attempt to produce oil from the sands.

It must be understood that the tar sands are not uniform or homogeneous and are not necessarily capable of continuous processing once an appropriate method has been developed. Syncrude's process therefore depends on complex chemical and physical reactions. The sands occur in great variation as to depth, thickness, richness of oil content and chemical and physical characteristics and it has been discovered that a process which successfully treats sands from one area often will not return satisfactory recoveries from sand from as little as a few hundred feet away horizontally or even less vertically. Syncrude has already had to move the site of its extraction operations some five miles and even here wide variation in chemical and physical characteristics has been found. In one case mining was undertaken in a 600 foot pit and at one end of that pit the sands were successfully processed but at the other end the formation became so hard that it could not be mined or treated by previously tested methods. Appendix III explains these operational variation risks in more detail.

Syncrude's processing plan envisages a life in excess of 20 years and differs from that of the Great Canadian Oil Sands plant in all phases. Mining will be done by dragline and scraper rather than bucket wheels. Extraction and froth treatment use different techniques. Bitumen conversion is by a new and considerably different process. Syncrude Canada has adopted these changes because it believes they are significant improvements, but this also means that Syncrude will be pioneering the application of these methods to the tar sands and will have to assume risks associated with pioneering in much the same manner as GCOS.

Syncrude's project is additionally subject to unique cost and inflation risks that are different both from conventional oil production and conventional mining. Conventional mining, with few exceptions such as gold, has historically been able eventually to pass on inflationary operating cost pressure by raising the price of its end product. Canadian crude oil prices on the other hand have been virtually constant for the past 20 years which forces Syncrude to proceed on the assumption that the price for its products cannot be increased. The conventional oil industry sells into the same inflexible price structure, but once a conventional well is on stream, it

involves relatively low continuing production costs and therefore labor and like cost pressures have comparatively limited effect. Syncrude's mining operation involves both disadvantages: a high component of operating cost and a fixed price for the product.

There are still other factors of an unusual nature which will also affect the Syncrude project:

(a) The long planning and construction period of about five years aggravates the element of risk in projecting current inflationary trends in the cost of labor and materials.

(b) The Syncrude project comprises several major operations, each of which is a highly complex series of sequentially dependent steps. Economics allow only minimum investment in stock piling and surge tank type of facilities or duplication of equipment to mitigate against breakdowns in one or other step of the process. Accordingly, a significant degree of risk has to be accepted with respect to achievement of a high level of operability.

(c) The remoteness of the location adds an element of risk not shared by many industries or large projects. This factor is of concern in the areas of services and supplies and in labor stability.

Based on current projections, the Syncrude tar sands project is only marginally economic. The large capital investment in a remote area using commercially unproved approaches in the face of increasing labor and material costs, without the prospect of being able to offset cost increases with higher product realization, makes it a high risk undertaking.

Even considering these risk factors, Syncrude is proceeding with research and engineering design on the basis of accepting a lower return than the risk would ordinarily dictate in order further to develop and to refine the technology and so lower the cost. It should be noted at this point that the location of Syncrude's proposed plant is one of the choicest sites from the viewpoint of richness of sand and depth of overburden. Most other parts

of the tar sand area are of lower grade or less attractive for one reason or another. Further development, therefore, cannot be anticipated unless cost reductions are realized.

Syncrude under its permit cannot commence production until 1976. Since the project requires three years for plant construction, the decision whether or not to proceed will not be made until 1973. The final assessment will be made at that time in the light of a number of variables including, of course, the tax climate and its effect on net investment yield.

MARKET PROSPECTS

The production from the tar sands is expected to find a market in the United States in the latter part of this decade - indeed Syncrude's permit was granted on terms that the oil be marketed outside Canada.

The U.S. demand for liquid hydrocarbons is expected to exceed conventional domestic supply (including Alaska) by approximately 4.5 million barrels per day in 1975 and by 6 million barrels per day in 1980. National defence considerations are expected to cause the United States to seek a large portion of supplies from continental rather than foreign offshore sources, and much of the gap could be filled by Athabasca crude.

Other sources of synthetic crude could also help supply this market, the foremost prospect being Colorado oil shales which are of the same order of magnitude as the Athabasca tar sands. The United States has recognized the importance of development of this resource such that in its 1969 Tax Reform Act it increased the depletion allowance available to taxpayers mining oil shale to produce shale oil thus providing greater incentive for its development while, at the same time, reducing the depletion allowances available for all conventional oil operations. (See Appendix IV).

Research and development programs on shale, including projects supported by the United States government, are aimed at developing technical information needed to permit commercial shale oil operations. As a specific example, one of the participants in the Syncrude project (Atlantic Richfield)

has extensive oil shale holdings and is currently involved in a large pilot plant operation. A second participant (Cities Service) also has Colorado oil shale holdings.

Thus, although demand in the long term will provide market opportunities for both the tar sands and oil shales, they are resources which will be competing for investment dollars. Technology and cost factors applicable to the Athabasca tar sands put the Alberta resource somewhat ahead of Colorado oil shale at the present time.

Investments tend to flow in the direction of the resource development that has been commercially successful. Therefore, unless the Athabasca tar sands can continue commercial development, and this time with a demonstrably successful plant, they could lose their timing advantage and their development could be greatly slowed.

Market forecasts of supply and demand and the potential of the sources of supply that are competitive to Athabasca crude are set forth in greater detail in the attached Appendices V and VI.

WHITE PAPER PROPOSALS

Syncrude has faith in its project. However, the project is marginal. Inflation, escalating costs, and pressures which will keep the price of crude from increasing, and may even reduce the price, weigh heavily on the viability of the project.

In paragraph 5.31 the White Paper proposes that the three-year mining exemption be withdrawn and in partial substitution taxpayers be allowed to write off the costs of certain depreciable assets up to the level of their otherwise taxable profits. In paragraph 5.40 the White Paper proposes that the present percentage depletion allowance be limited by reference to amounts spent on eligible exploration and development.

These two provisions are very significant in assessing the project. The proposed rapid write-off of certain fixed asset costs does not compensate or make up for the loss of the three-year mining exemption, and the concept of "earned" depletion has limited application in the circumstances of

the Syncrude project because there is no "exploration" as such to do. The Athabasca tar sands represent a resource the existence and location of which is and has been for many years well known.

The concept of earned depletion provides tax incentive only to the kind of resource development that requires risks to be taken in exploration activity. Some resources, including of course the tar sands, involve risk that is not at all related to exploration but to development and exploitation. Incentive for the development of that kind of resource is not provided by a depletion allowance that is related to the expenditure of exploration dollars.

Throughout most of the productive life of such a project income taxes would be sharply (50%) higher than under the present rules. This would cause a drastic reduction in net earnings and in the return on the shareholders' investment. If after careful consideration, the risk is unattractive to the investor, the project will be dropped. Thus it is not a question of the conceptual adequacy of the proposed substitutes, it is simply whether the government of Canada wants to see Athabasca developed. The adverse economic effect of discontinuing the existing three-year mining exemption and changing the present depletion provision will almost certainly kill the Syncrude project.

ALTERNATIVES FOR OIL INVESTMENT

An important consideration, when assessing the effects of the White Paper proposals, is that concerning alternative or competing investment opportunities for funds which will be needed for tar sands development. At a given point in time projects for the expenditure of oil development dollars involving Canada, offshore U.S., North Africa, the East Indies, or other locations come before the board of directors of a given oil company in numerous variety and one or another of the projects fails to be chosen. Alberta and Western Canada in general have enjoyed an allocation of some of those exploration and development dollars. These expenditures have been strongly influenced by the existing climate of expected after-tax return.

If Canada now substantially reduces the expected after-tax return from a given dollar employed in development programs in this country, Canada is to

that extent a less attractive alternative for investment by the various international oil companies. This means that Canada will tend to be decided against in terms of allocation of dollars for development programs for the future. This in turn means that since Canadian sources have so far exhibited no substantial ability to generate domestic capital to handle the monumental job of developing the unique Athabasca resource, it will tend to continue to lie dormant and unexploited.

SUBMISSION

Syncrude's submission is that the public interest with regard to development of the Athabasca tar sands will be best served by retention of the present percentage depletion allowance and three-year mining tax exemption. A tar sands mining operation is unique in that the value per ton of the material being mined is extremely low - far lower than for any major metal mining operation being conducted in Canada. This, in turn, requires large scale, extremely efficient materials handling methods in order to achieve unit costs sufficiently low to leave a margin for downstream processing and for profit. Whatever may be done about the three-year exemption with respect to conventional mines or depletion with respect to conventional oil or mining operations, and however depletion is viewed in concept, the simple fact is that the Syncrude project almost certainly will not proceed on the basis of a tax cost significantly increased from what has been projected under present rules involving both allowances.

If Syncrude does not proceed, there is no current indication that anyone else will; and the benefits from such a development will be lost for the foreseeable future to the detriment of the local, regional, and overall Canadian economy.

This concern with depletion allowance and the three-year mining exemption and their significance in any project to develop the tar sands is not new and indeed has been present from the outset. Prior to the amendments to Section XII of the Income Tax Regulations on December 23, 1957, there was no provision for percentage depletion on production from the Athabasca tar sands. The inclusion of a bituminous sands deposit as a resource under Section 1201 of the

amended regulations followed discussions between representatives of the Royalite Oil Company, Limited and the Department of National Revenue in November, 1957. Representatives of Great Canadian Oil Sands Limited exchanged correspondence with the then Deputy Minister of Finance in May and June, 1959, the company seeking and obtaining assurance that the three-year mining exemption and percentage depletion allowance would apply to its proposed operation in the Athabasca tar sands. The same assurances were sought and obtained on behalf of the Syncrude group in correspondence with the appropriate official of the Department of National Revenue in August, 1962. A brief was submitted in September 1967 to the Minister of Finance with respect to the report of the Carter Commission, in which the significance of the three-year mining exemption and percentage depletion was also stressed.

In elaboration of the foregoing, the following points should be stressed:

(a) The Syncrude project to develop the tar sands would require a capital outlay of over $200 million plus an additional $50 million - $100 million in electrical utility investment. Further, the project is a pioneering one, including the application of much research and new technology. Yet the products must be sold into a well established market where prices are set by external factors. Hence the investment risk is far greater than normal.

(b) The tar sands, if they can be developed economically, represent a long term secure supply of synthetic oil. In the United States the oil shales also represent a long term source of supply. Both sources have the common problem that, to be economic, they require large scale investment in plants having extremely low unit operating costs. The White Paper proposes sharply reduced fiscal incentives to the tar sands. In contrast, the U.S. government in its 1969 Tax Reform Act, while reducing the depletion allowances available to conventional oil operations, increased the depletion allowance available to its potential mining shale oil industry. It is suggested that the U.S. government is well aware of its long term vulnerability with respect to oil supply and is trying to do something about it.

Canada has an excellent chance to fill an increasing proportion of the U.S. supply gap, but the removal of incentives by implementation of the White Paper could well preclude Athabasca's sharing in this opportunity.

(c) Syncrude has a permit from the Oil and Gas Conservation Board of Alberta to start production in 1976. In its application upon which this permit was granted Syncrude states, "Upon approval of this application, the applicants will proceed with engineering and construction, with completion subject only to evaluation as required, of regulatory, fiscal, and economic factors which could seriously jeopardize the success of the project." Engineering work is proceeding, and the present schedule calls for completion of definitive engineering and economic studies by 1973 when construction must commence to meet a 1976 startup date. Syncrude's final assessment of the investment climate at that time, including tax impact, will determine the decision to proceed.

(d) Substantial reduction of the existing depletion allowance and the removal of the three-year exemption on which among other factors, the economic feasibility projections of the Syncrude project have been based, will almost certainly reduce after-tax yield below levels which are acceptable in relation to investment risks.

(e) Aside from tax considerations, the technical risks facing the developer remain large and to an extent unknown:

Item - Previous government and private process attempts prior to GCOS, as outlined in Appendix I, have all been unsuccessful.

Item - The only plant actually extracting oil from the sands has operated at a loss since inception in September, 1967. This reflects the difficulty in the implementation of efficient operations in extremely large plants.

Item - Syncrude has a process different from that of the plant just referred to. Its results have been encouraging at the pilot plant stage, but no full scale plant has in fact yet operated anywhere employing Syncrude's proposed process.

Item - The only other two companies (Shell Canada Limited, and Amoco Canada Petroleum Company Ltd.) to show serious interest in the development of the tar sands in recent years have respectively abandoned and deferred their permit applications before the Oil and Gas Conservation Board.

(f) The economic impact of a $250 million to $300 million investment in a remote and extremely impoverished area will be very beneficial.

(g) The regional economy will also benefit. Economist Dr. E.J. Hanson of the University of Alberta in a study of the economic impact of the Syncrude project prepared in August 1968 said in part:

> "the impact of the proposal of Syncrude Canada upon the economy of Alberta would be significant. By the 1970's it could add from 6,000 to 8,000 additional jobs of every kind to the labor force, generate sufficient additional income of $65 million or more to support from 15,000 to 20,000 more people in the province. The additional associated marketing of conventional crude would have an economic impact of the same order of magnitude. The revenue of the provincial government would be increased substantially, from royalties on synthetic production estimated at $12 million, from further royalties on the additional conventional crude marketed, and from the general expansion of the Alberta economy. The latter would be continuing to undergo the transformation and modernization which it has experienced since the discovery of the Leduc oil field in 1947."

The proposed 80,000 barrels per day synthetic crude plant will produce approximately 475 tons per day of sulphur as a by-product. In addition, Syncrude research chemists have determined the presence of many other potential by-products such as zirconium,

titanium, vanadium, and nickel. Also the spent sand which would be produced in great quantities constitutes a readily available source of supply of raw material suitable for the manufacture of glass. As an example, there exists a glass bottle factory at Medicine Hat, Alberta. At present, it is necessary for this plant to bring in its supply of raw sand in part from Winnipeg, Manitoba and in part from the State of Washington. Cleaned Athabasca sand produced as a by-product of Syncrude's process should provide a ready alternative to these sources of supply. Although present in the Athabasca deposit, many of the potential by-products exist in such minute concentrations that mining directly for a given ore or combination of ores is completely impractical. It is only through the oil recovery process that these materials become concentrated in volume sufficient to form the basis of a potential commercial operation. In the case of the sand, it becomes a potential marketable product only after it has been thoroughly laundered by the oil recovery process.

A tar sands project will bring together a combination, probably not equalled at any other location in Canada, of raw materials, electrical power, and fuel which will provide a broad base for future development in the area.

(h) If this project goes ahead, Canada will also gain by:

1. Direct tax revenues (33-1/3% taxation of a new source of income better benefits the Treasury than a 50% tax rate on nothing).

2. Tax revenues that will be generated indirectly from employment and services for the construction and operation of the plant.

3. Royalty revenues to Alberta

4. Other tar sands plants and satellite industries that would follow Syncrude's success.

Syncrude Canada Ltd. submits that the public interest in the development of the Athabasca resource requires retention of the three-year mining exemption and the present depletion allowance - not for Syncrude alone, but for the development of the Athabasca tar sands. If the present law regarding the three-year mining exemption and percentage depletion allowance is changed for conventional mining and oil operations, the Athabasca tar sands operation should still qualify for these allowances. These incentives are needed to hold estimated profitability high enough to permit Syncrude's or any other project to go forward.

The basic question, whether expressed or not, that underlies all Canadian debate on economic policy, foreign investment in Canadian industry, balance of payments, standard of living - now even tax reform, is that of the rate at which the Canadian natural resources should be developed. Given infinite time, Canadians themselves could accumulate enough capital to develop fully this country's resources, but most Canadians are not prepared to wait that long. Therefore, foreign capital must be attracted to get on with the job, and in the process maintain for Canadians the high standard of living they have come to expect.

Syncrude Canada Ltd. wishes its position to be perfectly clear on this point: Athabasca is a resource that if not developed now may well lie dormant for the foreseeable future. This is not a question of <u>rate</u> of resource development; it is a question <u>whether</u> the present momentum of development is to be sustained. Under today's economic environment and at the current stage of technological advancement, one of the highest grade areas (that selected by Syncrude for its project) looks only marginally attractive, while most of the remainder of the area appears to be uneconomic. Unless there is additional experience gained through continued efforts at commercialization, Canada faces a real risk that future technical progress will not be able to offset rising costs with the result that the resource could become worthless. As this brief has hopefully made clear, it is a question not of <u>when</u>, but <u>whether</u>, the development will take place. A policy of removing incentives to await eventual development would be, with respect, one of serious folly in relation to the Athabasca tar sands. The abolition of the three-year mining exemption and the present percentage depletion will almost certainly kill the Syncrude project.

APPENDIX I

HISTORY OF THE SYNCRUDE CANADA LTD. ATHABASCA PROJECT

The tar sands of Athabasca have long been an enigma: their presence has been known for almost 200 years but until fairly recent years commercial extraction of that oil had been precluded by prohibitive separation costs. Gordon R. Coulson, a Calgary contractor, saw that the most difficult problem was somehow to remove the sand and clay from the oil, rather than the normal process of removing the oil from host material. He put some tar sand, water, and kerosene in his wife's washing machine, turned on the machine, and thus invented the centrifuge process he patented in 1953. The result was three separated levels, one each of oil, water, and sand. Coulson formed Can-Amera Oil Sands Development Company Ltd. to develop his patented process.

In 1949 the Alberta Government had constructed a five hundred ton per day oil sands separation plant at Bitumount to utilize the hot water separation process that had been developed by the Research Council of Alberta. Coulson's Can-Amera Company, now named Can-Amera Export Refining Company Ltd., purchased the plant in 1955 and used it for experiments utilizing and testing the Coulson centrifuge process, which involved the dilution of the tar sands with diesel oil to effect the separation, and then centrifuging to eliminate sand and fines from the bitumen.

In 1955, Can-Amera made an agreement with Royalite Oil Company, Limited calling for Royalite to carry on the research work and purchase the Bitumount plant for $180,000, which made available to Royalite the rights to utilize the Coulson centrifuging process with reimbursement to Can-Amera for its earlier work. In addition, Can-Amera obtained and still holds the right to acquire ten percent of whatever working interest Royalite might ultimately obtain in a commercial project. Royalite and Can-Amera acquired what is now Oil Sands Lease Number 17 in December 1955 and continued the experimental program at Bitumount and on the area covered by that lease. Because of severe operating problems, the centrifuge process was abandoned in favor of more conventional separation techniques.

In June 1958 Royalite made an agreement with Cities Service Company, a major U.S. refiner, by which Cities Service acquired a 90% interest in the project in return for undertaking to make 100% of the future expenditures up to a cumulative total of $18,390,000 at which point Royalite's then existing expenditures of $1,839,000 would be equated on a 90%-10% basis. Cities Service had been conducting research on oil sand extraction processes at its Lake Charles, La., refinery in 1957 and was interested in the possibilities for extraction of oil from the sands using a warm water process as a result of its own laboratory and bench scale studies of various extraction methods.

With Cities Service as operator of the project, a thirty-five ton per hour pilot plant was installed in 1959 at Mildred Lake on Oil Sands Lease No. 17. By the end of that year, the project had cost $8,500,000. The pilot plant was designed as a research tool and it was operated to gather information on the mining and materials handling problems as well as on the performance of the extraction process.

About the middle of 1959 Richfield Oil Corporation acquired from Cities Service one-half of its working interest in the project. On October 1, 1959, Imperial Oil Limited joined the three-company group and the working interests in the project came to their present position of 30% each to Imperial, Cities Service, Atlantic Richfield Canada Ltd., and 10% to Gulf Oil Canada Limited. (Atlantic Richfield Canada Ltd. represents the continuity of Richfield Oil Corporation's interest through the merger with The Atlantic Refining Co. and subsequent change in Canada to Atlantic Richfield Canada Ltd., and Gulf Oil Canada Limited, formerly British American Oil Company Limited, replaced its interest when it amalgamated with Royalite in 1969.)

A major research and testing program was conducted at the project site at Mildred Lake from mid-1959 until January 1964, with the facilities including a large tar sands extraction pilot plant, mining and materials handling equipment, a steam plant, power plant, shops, laboratory, warehouses, air strip, and housing and commissary for an average crew of about 125 people. In addition, an engineering and office staff of about 50 people was located in Edmonton.

During the work on site at Mildred Lake, the warm water oil extraction process proved to be economically less attractive than a new extraction method, the modified dense phase process. Experimental testing for the new method took place on a 1000 pounds per hour bench unit which was constructed at Mildred Lake in addition to the main pilot plant. Although limited facilities had been installed at Mildred Lake to test the bitumen upgrading process, field work in this area was not necessary because normal refining techniques were considered applicable to this material. Mining and materials handling procedures were tested with bulldozers, a small mining wheel, blasting, and belt conveyors. It will be appreciated that the major problem in oil sands processing is that of handling vast quantities of sand, at a very low cost, and the operation is to a large degree related to mining rather than conventional oil production although the end product is oil.

On May 9th, 1962 Cities Service Athabasca, Inc. on behalf of the four-company group, made application for a license to produce 100,000 barrels per day of synthetic crude and 500 tons per day of sulphur. At this stage the project had cost over $15,000,000. The application was heard by the Alberta Oil and Gas Conservation Board in January 1963. Approval was sought for a $356 million project to produce 100,000 barrels per day of synthetic crude extending over a period in excess of 20 years with startup scheduled for 1969.

The project involved four phases:

(1) mining of sands,

(2) separation of the sand and bitumen,

(3) upgrading the bitumen into a high quality synthetic crude, and

(4) moving the crude through a 295 mile pipeline from the plant site to Edmonton where the product could enter the Interprovincial or Trans Mountain pipeline systems or both.

The manpower requirements were estimated to vary from one thousand to four thousand men for the project over the four year construction period. Manpower requirements for operating and maintaining the plant, power plant and pipeline would number in the neighbourhood of 1,700 with an annual payroll of about $14 million.

The Conservation Board announced deferment of the application in October 1963, but the applicants were invited to re-submit their application or amended application before the end of 1968. As a result the four-company group continued with its research and development activity at Mildred Lake until January 1964 and since that time at Edmonton, Alberta where a basic research and pilot operation was established in early 1964. (By the time the Mildred Lake facilities were shut down a total of over $22 million had been spent. Since moving the research and testing facilities to Edmonton, the group has spent an additional $7,512,000 bringing the overall total expenditures to $29,824,000.)

The Alberta Oil and Gas Conservation Board cited the Alberta Government's Oil Sands Development Policy, as enunciated by Premier Manning in October 1962, as the reason for rejecting Syncrude's application. The policy was designed to ensure that the position of conventional oil in Alberta (at 47% of productive capacity in 1962) was not jeopardized by loss of limited markets to a new source of supply from the tar sands. The concern of the Alberta government was obvious, since the conventional oil industry generates over 40% of total provincial revenue in the form of Crown sale bonuses, rentals and royalties.

The policy placed no restriction on such production from the tar sands as might be able to enter markets clearly beyond present or foreseeable reach of Alberta's conventional industry. However, for such tar sands production as would be competitive in present or foreseeable markets for conventionally produced Alberta crude oil, the government decided that the best interest of the province would be served:

(a) in the initial stages of oil sand development by restricting production to about 5% of the total demand for Alberta oil, i.e. at a level of the order of that approved for Great Canadian Oil Sands;

(b) as market growth enables the conventional industry to produce at a greater proportion of its productive capacity by permitting increments in oil sands production as recommended by the Oil and Gas Conservation Board, on a scale, and so timed as to retain incentive for the continued growth of the conventional industry;

(c) by relating the scale and timing of oil sands production to the life index of provincial reserves of conventional oil, allowing the index to decline gradually from present levels (21 years in 1962) to ensure that it does not drop below 12 or 13 years.

The deferral of the application by the Conservation Board in October 1963 caused a change in the character of the project being operated by the four-company group. The ruling eliminated the possibility of starting commercial construction for some further years, and accordingly the Mildred Lake operations were shifted to Edmonton where a basic research laboratory as well as a pilot plant capable of processing tar sands at the rate of 1,500 pounds per hour were built and placed in operation.

Syncrude Canada Ltd. was incorporated on December 18, 1964 and as of January 1, 1965 took over control of the operation of the project for the four companies in the group. The company itself serves as an operator for its four shareholders on a no-profit, no loss basis, in controlling and managing the project.

In the period following 1963 there were several developments which have a significant bearing on the Syncrude project. First, further evaluation of reserves established a commercial mining area with a low overburden ratio and more readily processable tar sands. Second, it was established by extensive field testing that tar sands can be mined with conventional scrapers, resulting in mining costs lower than earlier estimates. Third, a market study provided an insight into more realistic values for the synthetic crude plus a potential for the sale of certain specialty oils, particularly in the form of low sulphur - high quality fuel oils. Fourth, the scraper mining studies, test work carried out by Syncrude on extraction-froth treatment and improvements by industry in hydrotreating techniques increased confidence in the technical feasibility of the project. The Syncrude staff concluded that with these improvements a 34.0° API synthetic crude could now be produced at costs (when considering the additional value of the synthetic crude) which would compare favourably with that of average conventional Canadian crude. The capital requirements were revised and re-estimated to be considerably less than those presented in the 1962 application. The conclusion was that these lower costs provided the flexibility to reduce throughput to something less than 100,000 barrels per day of synthetic crude and specialty oils.

At approximately the same time, other developments led to an overall reappraisal of the Syncrude project and made it essential that a determined effort be made to obtain a revision of the 1962 policy. These other developments included:

(1) A marked upturn in the discovery rate and probable reserves-life index for Alberta oil in 1964 and 1965 which at that time raised the possibility that the 1962 provincial policy would not allow any additional tar sands development for as long as another 15 to 20 years.

(2) The probability of a rapid increase in the gap between United States domestic supply and demand, particularly in Districts I and II.

From the standpoint of corporate planning, it became necessary for each of the four participants to determine whether or not they wished to continue indefinitely on a research and field testing program which had already resulted in an expenditure of approximately $24,000,000 by the end of 1964.

In September of 1965, after weighing these factors, the Syncrude management committee approved the initiation of discussions with the Provincial Government regarding Oil Sands Policy revision.

After a number of preliminary meetings with Government representatives, Syncrude submitted several briefs dealing with commercial development of the Athabasca tar sands to Premier Manning as did other companies and associations interested in this subject. These briefs, together with meetings called by Premier Manning on May 11, 1966 and on June 16, 1967, with representatives of the Alberta oil industry, led to reconsideration of the Government's oil sands development policy.

On February 20, 1968, Premier Manning tabled in the Legislative Assembly of the Province, a further statement of the Oil Sands Development Policy. The essential modifications are:

(1) The distinction between "within reach" and "beyond reach" markets is clarified. "Beyond reach" markets are stated to be any markets, including specialty markets, which Alberta's conventional industry is not now serving nor can reasonably be expected to serve in the foreseeable future because of price, quality specification or other reasons. Athabasca product can enter these markets without limitation.

(2) Where it can be demonstrated that the applicants' proposal would provide growth by the development of a "new" market within reach of conventional industry, production from oil sands may be authorized in volumes equal to 50 percent of the new market. However, the total volume of commercial oil sands production, including that already authorized, that will be permitted to enter new within reach markets, will be 150,000 barrels per day, which limit will remain in effect for 5 years.

(3) A scheme proposing marketing of oil sands production in a "within reach", but not "new" market, would be approved only when indicated by a trend in the life-index of the conventional industry. The percent utilization of productive capacity criterion is no longer useful and is being discontinued.

On May 3rd, 1968, Syncrude submitted an amended application requesting permission to build a plant of 80,000 BPD capacity by 1973, to cost, exclusive of townsite development, pipeline and power plant, approximately $200,000,000. Of the requested total output, 50,000 BPD would represent synthetic crude oil to be disposed of in "new within reach" markets. The Syncrude participants agreed to find new markets for a similar volume of conventional crude oil in accordance with the provision of the modified Oil Sands Policy. The remaining 30,000 BPD of plant output would be disposed of in "beyond reach" markets, 25,000 BPD as a premium industrial fuel oil, and 5,000 BPD as naphtha.

During the course of the hearing before the Alberta Oil and Gas Conservation Board, held in August, 1968, a somewhat rigid interpretation of the conditions necessary to satisfy a "new within reach" market evolved as a result of the very active intervention of a sizable segment of the conventional oil industry. Restrictions on all movements to the U.S. would have to be largely eliminated for a new within reach market to exist. The best available forecasts of the U.S. domestic supply/demand situation, prepared in early 1968, indicated that such condition would probably become a reality in 1974. However, during the summer of 1968, the announcement of a major oil discovery at Prudhoe Bay introduced a new element of uncertainty into the U.S. supply picture. The Conservation Board announced in December 1968 that they could not approve the application because of the unknown magnitude and rate of development of the Alaskan discoveries. In the belief that more information would be forthcoming shortly the Board said that they would be prepared to approve the application, following a further hearing to be held in November, 1969, if the applicants could satisfy the Board that the balance of probabilities, as they may then best be assessed, favoured the contention that the probable Alaskan developments would not significantly reduce the deficiencies originally anticipated in the United States indigenous supply of crude oil in the period 1973 to 1974.

The participants in the Syncrude project concluded that it was unlikely that sufficient additional information about the probable extent of the Alaska reserves would be available by November 1969 to satisfy the Board and, as a result they would be judged on the basis of the Board's assumed "high" Alaska case. The participants on February 19th, 1969 submitted a proposal to the Lieutenant Governor in Council requesting that he consider seeking the advice of the Board to determine whether the Board would consent to modify the conditions under which they would be prepared to hear an amended application based on the following proposals:

(1) an amendment to the application to provide for an approximate three-year delay in startup, and

(2) submission of new data indicating a higher future U.S. demand

The Oil and Gas Conservation Board granted this request and on March 24th, 1969 Syncrude Canada Ltd. submitted an amended application proposing a three-year delay in startup supported by updated U.S. supply/demand figures. The hearing was held May 26th-27th, 1969.

On September 12th, 1969 the Alberta Oil and Gas Conservation Board issued Report 69-C authorizing Syncrude Canada Ltd. to build a plant with 80,000 BPD capacity to go onstream not before July 1st, 1976.

During the 1969 hearing before the Oil and Gas Conservation Board, and later in private discussions, Canadian Utilities Ltd. indicated its interest in building a major utilities plant in connection with the Syncrude oil project. This plant would utilize, as fuel, the residual material remaining after upgrading the tar sand oil in a thermo-electric plant to produce a base load of 100 megawatts of electricity for Syncrude plus a substantial block of power to be fed into the province-wide electric grid system.

In addition, this utilities plant would supply the Syncrude project with 17,000,000 pounds of steam and 2,000,000 gallons of treated water per day. In terms of size, the electrical capacity of the Canadian Utilities plant would be approximately equivalent to a plant supplying a city of over 200,000 population. Investment in the overall utilities complex would be in the range of 50 to 100 million dollars. This investment, when combined with the outlays required for the mining, extraction, and upgrading complex, and the pipeline facilities would bring the total capital expenditures to approximately $300,000,000.

SEE LAST PAGE OF THIS ISSUE FOR APPENDIX II

PROPOSED PROJECT PLAN

APPENDIX III

RISKS PECULIAR TO TAR SANDS DEVELOPMENT

The risks in conventional oil and gas exploration and development are well known. These are recognized by permitting exploration and development expenditures to earn depletion. There are also large risks inherent in bringing a tar sands project on stream but these do not earn depletion.

In conventional oil well drilling, geologists are usually able to correlate information from well to well and predict with some degree of accuracy the limits and characteristics of a given producing structure. In the case of the tar sands, due to the rapid lateral and vertical changes in sand characteristics, core hole data cannot be accurately correlated, with the result that a given core hole yields useful information relative only to an area immediately surrounding the hole.

Apart from the fact that the tar sands occur in great variation as to depth, thickness, and richness of oil content, they exhibit finite chemical and physical variations narrowly defined by area. The present process for oil extraction depends on finely balanced chemical and physical reactions and a process developed to treat sand from one area often will not return satisfactory recoveries from sand from another area as little as a few hundred feet away horizontally or even less vertically.

Syncrude has already been required to move the site of its extraction operations. The experience with the sands area being developed during the period when its application to the Alberta Oil and Gas Conservation Board was first submitted proved unsatisfactory and operations were moved some 5 miles to the present location. Even here extreme variation has been found. In one case, a pit 600 feet long was dug after drilling results had indicated the presence of sand of a particular type. As mining progressed however, it was found that the variations within the 600 foot excavation were such that the sands from one end of the pit could not be mined or handled by tested methods to produce satisfactory yields although results were quite acceptable where mining started.

A change of chemical content of the feedstock requiring corrective measures in commercial extraction would add substantially to plant expense. The recovery of bitumen and the quality of the resulting froth vary markedly for different tar sands. Not only do the water and solids content of the froth vary but completely different methods of removing these contaminants might be required. For instance, Syncrude proposes to remove the water from the froth by thermal dehydration, a process which has worked well in small scale equipment on the feedstocks investigated to date from the area Syncrude is developing. However, a similar process was utilized by the International Bitumen Company and the Alberta Research Council in the Bitumount plant in 1947 - 49 and, after much grief, abandoned. The Alberta Research Council concluded that "the elimination of water by evaporation from wet crude bituminous sand oil, while possible of accomplishment, is not practical. The stability of the oil-steam froth generated makes for a slow operation which is difficult to handle". Apparently the bitumen charged at Bitumount contained surface active agents which contributed to a severe foaming problem.

While Syncrude believes that its studies have minimized the risks from these sources of potential difficulty that are inherent in the tar sands deposit, they are still present in a large measure. In addition, the factors of escalating costs and stationary crude oil prices are subjecting the project economics to a tremendous squeeze.

During the period from 1950 through 1966, the labor cost component involved in refinery-type construction increased at about 5% a year and the materials component increased at about 2.5% a year. These cost increases were largely offset by continuing productivity improvements in refinery design, materials and equipment, and construction techniques, coupled with a modest increase in the price of oil products (considerably less than the rise in the wholesale price index for all commodities). However, over the past three years, construction wages have been increasing at 9% a year and material costs at 6½% a year, both much higher than recent productivity increases. Canadian crude oil prices, on the other hand, are the same now as in 1962. Various interests in the United States are campaigning vigorously in favor of increased foreign oil imports, with the objective of forcing back U.S. crude and product prices.

The price of Canadian crude, which competes with U.S. domestic crude in several important U.S. areas, could be subjected to serious downward pressure should the U.S. government decide to alter radically its present import policy.

Adverse tax treatment, in combination with the above noted factors, would have very serious ramifications with respect to future tar sands development because a tar sands producer must face the technical risk and the problem of coping with inflationary construction and operating costs without the flexibility of being able to offset such costs by increased product realization.

APPENDIX IV

UNITED STATES TAX REFORM BILL OF 1969

(In Part)

Prior to the enactment of the Tax Reform Bill of 1969 the Internal Revenue Service took the position that oil shale was subject to percentage depletion at the rate of 15% of gross income, subject to a limitation of 50% of the net income from the property. Gross income was computed on the value of the crushed rock after it had been removed from the earth, brought to a central point and crushed. The Tax Reform Bill of 1969 changed the point of depletion to the value of the kerogen extracted from the shale after the shale had been extracted from the earth, brought to the central point, and crushed and processed in the retort and the waste shale disposed of. The net effect of this change in definition regarding mined oil shale is to increase the allowable depletion by approximately 100%. The amount of the increase would depend upon the particular operation involved as to the relationship of the value of the crushed rock and the value of the kerogen after the retort operation.

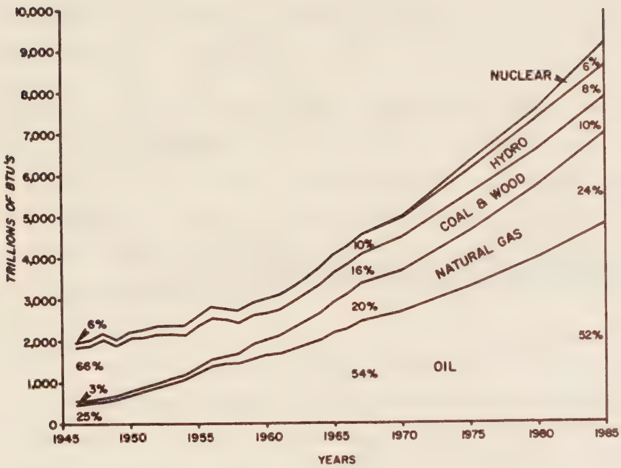
This increase in the allowable depletion in the case of mined oil shale was enacted in the Tax Reform Bill which reduced the depletion for oil and gas from 27-1/2% to 22% of gross income (not to exceed 50% of the net income from the property).

APPENDIX V

THE DEMAND FOR LIQUID HYDROCARBONS

Fig. V - I

CANADIAN ENERGY CONSUMPTION



C.P.A. - March 1969

A. DOMESTIC ENERGY DEMAND IN CANADA

Since 1947 the demand for energy in Canada has grown at an average annual rate of 4 percent to its current level of 4,700 trillion BTUs per year, as shown in Figure V-1. This growth in energy demand has been marked by increased use of petroleum products in the transportation sector and the rapid increase in residential and commercial consumption of natural gas.

The projected population growth in Canada, combined with gradually increasing per capita consumption of energy, is forecast to bring energy demand to a level of 9,200 trillion BTUs per year by 1985. This represents an annual growth rate slightly less than 4 percent in the forecast period. Oil and natural gas will continue to supply about three-quarters of Canada's energy requirements, with coal, hydro power and nuclear power supplying the balance. Oil's share of the energy market is expected to decline only slightly from the present 54 percent to 52 percent in 1985, while the share supplied by gas will continue to grow from the present 20 percent to 24 percent.

Liquid hydrocarbons are indispensable for transportation. Even if the electric automobile were to become economic, present indications are that it would not displace the internal combustion engine for many years to come, and technology for replacing liquid fuels in air transportation has yet to be developed. There is little prospect that electricity will materially replace gas and oil in the residential heating market for several decades. Thus, while electric power generation, assigning a rapidly increasing role to nuclear plants, will probably make growing inroads in the energy market in the long term, the dominant position of oil and gas is expected to be maintained throughout the rest of this century.

B. CANADIAN LIQUID HYDROCARBONS RESERVES

Canada's recoverable liquid hydrocarbon reserves from conventional sources which comprise crude oil and natural gas liquids increased from 1.2 billion barrels in 1950 to 10.02 billion in 1968, an average annual increase of 490 million barrels. Crude oil reserves made up 8.38 billion barrels of the 1968 total, with natural gas liquids providing the balance. Annual production over this period increased from 29 million barrels to

Fig. V-2

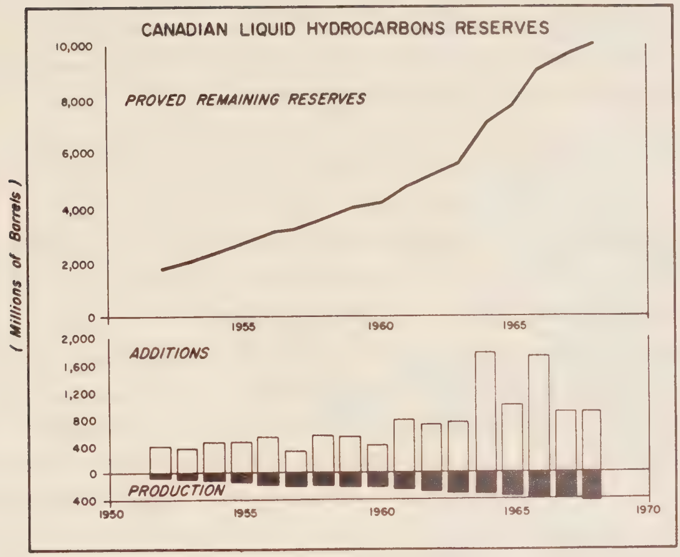
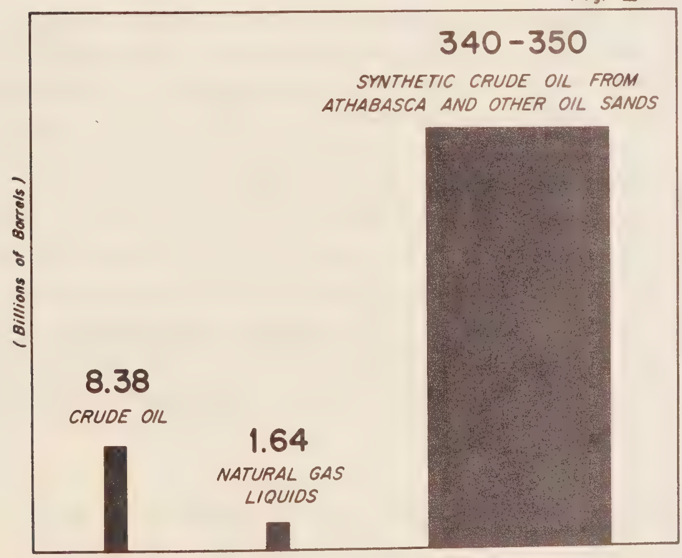


Fig. V-3



PROVED RECOVERABLE RESERVES OF LIQUID HYDROCARBONS IN WESTERN CANADA

(as at Dec. 31, 1968)

Sources : C.P.A. Reserves Committee and Alberta Oil and Gas Conservation Board.

432 million barrels (1.18 million barrels/day). The more rapid reserves growth in later years is shown in Figure V-2 and was primarily due to reassessment of potential recovery from previously discovered reservoirs and improved recovery techniques used in many pools.

The Province of Alberta contains the bulk of Canada's proved remaining recoverable reserves with 7.25 billion barrels of crude and 1.59 billion barrels of natural gas liquids. Similarly, Alberta has been the major producing province, producing an average of 0.84 million barrels of liquid hydrocarbons per day of the total Canadian production of 1.18 million barrels per day during 1968[1].

The Canadian Petroleum Association recently completed a geological estimate of the potential recoverable reserves of oil, natural gas and associated sulphur in all of the potential hydrocarbon areas of Canada[2]. The estimate includes amounts already produced, amounts considered to be proven and probable in known accumulations, and amounts yet to be discovered on the basis of geological predictions. This study assigned potential recoverable reserves of 120.8 billion barrels of crude oil for all of Canada.

Figure V-3 provides a comparison of the proved recoverable reserves of Canadian conventional liquid hydrocarbons with the reserves in the oil sands of Alberta from the Alberta Oil and Gas Conservation Board report of 1963 entitled, "A Description and Reserve Estimate of The Oil Sands of Alberta". The Board established reserves in place of 625.9 billion barrels in the oil sands of the Athabasca deposit; yielding recoverable reserves of 369.1 billion barrels of raw oil sands-oil, or 266.9 billion barrels of upgraded synthetic crude oil. A more recent study by a Syncrude Canada Ltd. task force provides a somewhat higher figure of 286 billion barrels for recoverable reserves of upgraded synthetic crude oil with increase being primarily due to the fact that a larger percentage of the overall Athabasca deposit was assigned to the mineable area with its higher recovery factor.

1 1968 Canadian Petroleum Association Statistical Year Book.

2 "Potential Reserves of Oil, Natural Gas, and Associated Sulphur in Canada", by Geological Reserves Committee, Canadian Petroleum Association, April 1969.

Fig. V-4

*Commonly called Athabasca Tar Sands

APPROXIMATE RECOVERABLE RESERVES
OF
SYNTHETIC CRUDE OIL

	(Billions of Barrels)
Athabasca	286
Cold Lake	30
Peace River	20
Wabasca	14
	350

MAJOR OIL SANDS DEPOSITS OF ALBERTA
(From Alberta Oil and Gas Conservation Board - Oct 1969)

The Syncrude study concluded that the mineable portion of the Athabasca deposit contained recoverable reserves of upgraded synthetic crude oil of 86 billion barrels. The inclusion of other smaller deposits brings the grand total of recoverable reserves of upgraded synthetic crude oil to 340-350 billion barrels, as shown on Figure V-3. (See Figure V-4 for location of deposits.)

C. CANADIAN SUPPLY AND DEMAND

Domestic Production and Demand

Canadian production of liquid hydrocarbons increased almost sixty times (average 21 percent per year) in the period 1947 to 1968. Domestic demand increased almost five-fold (average 8 percent per year) in the same period. When production is compared to domestic demand, Canadian self-sufficiency rose from 8 percent in 1947 to 94 percent in 1969. During the first quarter of 1970, based on estimates of demand and refinery nominations, domestic production will - for the first time - exceed demand, as shown on the following table:

TABLE I

DOMESTIC PRODUCTION AND DEMAND
(Thousands of Barrels per Day)

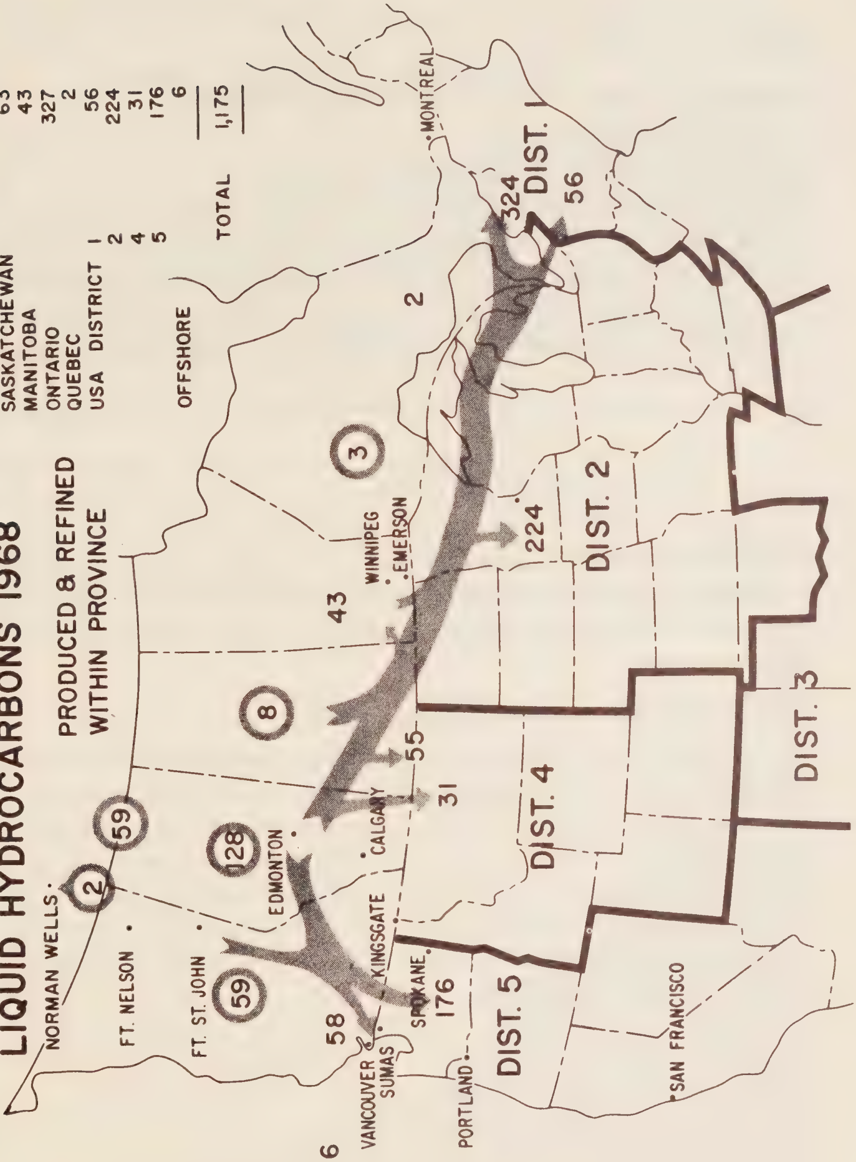
	1947	1957	1967	1968	1969	1st Qtr. 1970
Domestic Demand	267	744	1,292	1,373	1,410*	1,500*
Domestic Production	21	506	1,110	1,197	1,321*	1,639*
Prod. as % of Demand	8%	68%	86%	87%	94%	109%

* Estimated

Source: "Selected Statistics on the Petroleum Industry in Alberta and Canada, 1959-1968", Oil and Gas Conservation Board of Alberta, July, 1969.

Fig. V-5

DISPOSITION OF CANADIAN LIQUID HYDROCARBONS 1968



Disposition of Canadian liquid hydrocarbon production in 1968 is shown in Figure V-5.

Imports Into Canada of Crude Oil and Refined Products

About half of Canadian domestic demand is supplied by overseas imports of low-cost Middle East and Venezuelan crude oil and refined products into Quebec and the Maritimes. It would appear to be the view of the government that the National Oil Policy, which substantially reserves markets west of the Ottawa Valley for indigenous oil with foreign supplies having free access to the rest of the country, does not involve any major dangers as to security of supply. However, it is likely that if oil in large quantities is found off the East Coast of Canada or in the Canadian Arctic that this oil will displace offshore imports to an increasing degree.

Crude oil imports into Canada rose from 294,000 barrels per day in 1958 to 484,000 barrels per day in 1968, for an average annual increase of 5.1 percent. Refined product imports increased from 80,000 barrels per day to 201,000 barrels per day over the same period, for an average annual increase of 9.6 percent. Canada's total imports of crude oil and refined products for 1968 averaged 673,000 barrels daily after deducting minor product exports.

Forecasts of Future Canadian Domestic Demand

Three recent forecasts are available to demonstrate the range in estimates of future total Canadian demand for crude oil and equivalents, and these forecasts are basically attempts to predict the growth rate at which Canada will consume energy. Such forecasts are aided by the demonstrated correlation between energy consumption and the growth of Gross National Product and industrial production. Historically, such forecasts usually err on the side of conservatism, as will be noted in the section entitled "United States Demand".

Fig. V - 6

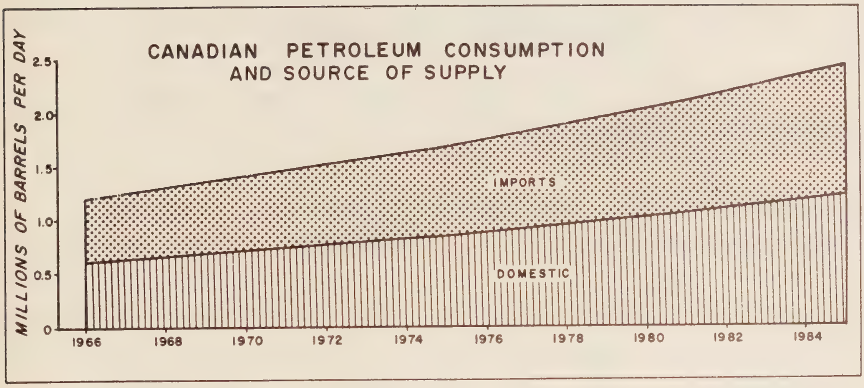

CANADIAN PETROLEUM CONSUMPTION
AND SOURCE OF SUPPLY
MILLIONS OF BARRELS PER DAY
2.5
2.0
1.5
1.0
0.5
0
IMPORTS
DOMESTIC
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984

Fig. V - 7

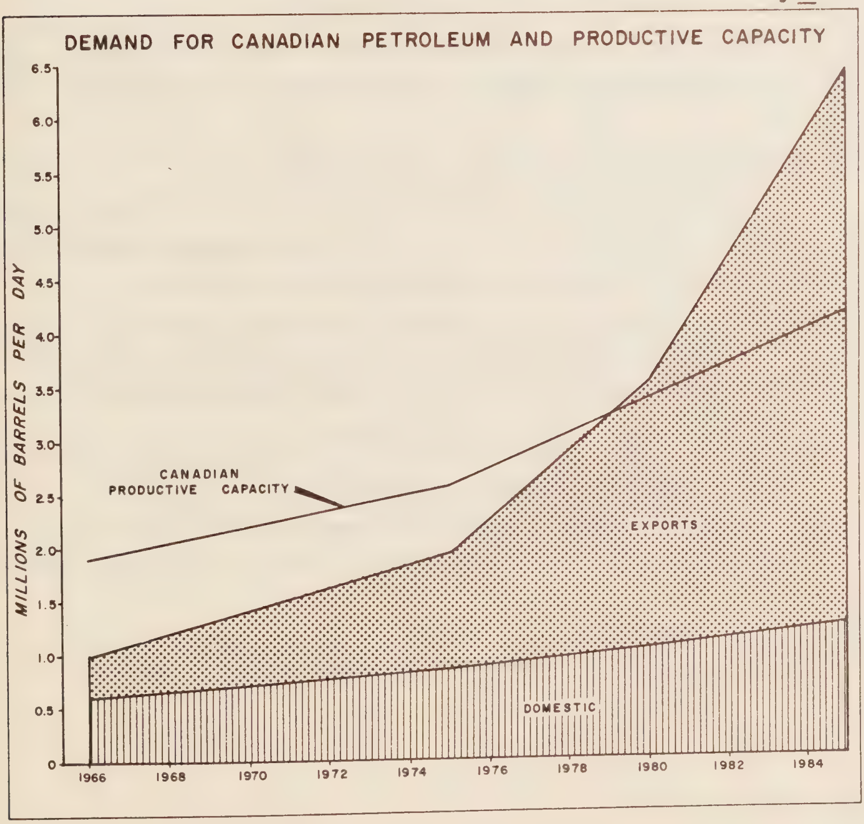

DEMAND FOR CANADIAN PETROLEUM AND PRODUCTIVE CAPACITY
MILLIONS OF BARRELS PER DAY
6.5
6.0
5.5
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0
CANADIAN
PRODUCTIVE CAPACITY
EXPORTS
DOMESTIC
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984

TABLE II

FUTURE CANADIAN DOMESTIC DEMAND
(Millions of Barrels Per Day)

	1970	1975	1980	1985
First National City Bank Energy Memo, April 1968	1.39	1.74	2.12	-
National Energy Board, Ottawa, 1969	1.41*	1.68	2.04	2.44
Foster Report, Oct. 1969	1.5	1.88	2.25	2.65**

* Interpolated
** Extrapolated

In comparing forecasts in Table II it will be seen that the National Energy Board has taken a conservative view of the growth in Canadian demand in that it applied an average annual growth rate of 3.8 percent. In contrast, the more recent Foster study[1] utilized a 4.2 percent average annual growth rate for its "lower range" forecast, with the other two growth rates at 5.1 and 5.9 percent.

Figure V-6 illustrates how the National Energy Board forecasts that Canadian demand will be met by domestic production and offshore imports.

Forecasts of Future Demand for Canadian Liquid Hydrocarbons

It is more difficult to forecast the future level of over-all demand for Canadian liquid hydrocarbons, since even the short-range outlook is currently subject to a number of uncertainties. These include:

1. The current review by the Canadian government of its policies relative to the importation of petroleum. Any changes in the existing policy will have an effect upon the volume of Canadian production for Canadian markets;

2. The current review by the United States government of its policies regarding petroleum imports and supply arrangements. The level of future Canadian exports to the United States will be directly related to that country's import policies and production from domestic sources including Alaska;

[1] Prospective Demand for Canadian Crude Oil Under Alternative Industry and Canadian-United States Government Policies, by Foster Associates, Inc., October, 1969.

3. The timing and magnitude of any future discoveries in one or more of the Canadian "frontier areas" (the Arctic Islands and offshore, Hudson's Bay, the Atlantic offshore, the Gulf of St. Lawrence, and the Gaspé) and in that portion of the Western Canada Sedimentary Basin in the Northwest Territories. The timing and relative cost of new discoveries and their relative proximity to market could affect the level of demand on developed reserves and the rate of finding replacement reserves.

Forecasts by the National Energy Board have been utilized in Table III on overall demand for Canadian Petroleum, although certain minor adjustments have been made in the level of exports for 1975 and 1985. A critical assumption in the forecast of exports is that U.S. imports from overseas continue at the current percentage of total U.S. demand.

TABLE III

TOTAL DEMAND FOR CANADIAN LIQUID HYDROCARBONS
(Thousands of Barrels Per Day)

	1966	1975	1980	1985
Canadian Demand	641*	846	1,027	1,240
Exports or Export Opportunity to U.S.	372*	1,100	2,500	5,200
Total	1,013*	1,946	3,527	6,440
Productive Capacity	1,908	2,567	3,399	4,269

* Adjusted to reflect inventory change of 22 M Bbl/Day

Canada's Productive Capacity

An estimate of the maximum amount of conventional liquid hydrocarbons that Canada will be able to produce in the future is also shown on Table III. This forecast, developed by Syncrude Canada Ltd., is generally comparable to the National Energy Board's case which goes beyond production from the Western Canada Sedimentary Basin and assumes significant discoveries and production in Canada's frontier areas. For 1975 and 1980 the forecast productive capacity is higher than the maximum level estimates by the National Energy Board, while in 1985 the figure lies midway between their high and low sub-cases.

Canada's productive capacity is now substantially in excess of current domestic and export demand, but the growth in Canadian consumption west of the Ottawa Valley and the even greater anticipated growth in exports to the United States will narrow this gap at a moderate rate until about 1975. The growth of the United States market will be discussed in detail in the following sections. After 1975, as shown on Figure V-7, the gap will close rapidly and the combined export and domestic demand for Canadian liquid hydrocarbons will exceed available supply by about 1980. After 1980, despite substantial production which may be developed in the "frontier areas" of Canada, an increasingly large share of the United States market will go by default to other sources of supply unless Canadian conventional productive capacity is supplemented by large new tar sands developments.

D. GROWTH OF EXPORTS TO UNITED STATES

The history of Canada's petroleum export trade began in 1951 and is, by virtue of geography, closely tied to the United States. To illustrate the growth in this export market the table which follows shows total Canadian liquid hydrocarbon production from 1951 through 1970 and Canadian liquid hydrocarbon exports to the U.S. for this period. In 1961, as an example, exports to the United States amounted to 28.7 percent of total Canadian production and by 1969 such exports had increased to 44.7 percent of total Canadian production. During this period Canada's total production increased by 106 percent. Although the increase in exports as a percentage of total production does not appear to be striking, exports in 1969 were three times the 1961 level. The increase in exports in 1970 to the U.S. will be dramatic, although the high level of exports anticipated for the first quarter may not prevail throughout the year if the U.S. Government chooses to enforce the agreement with Canada on the level of Canadian exports.

TABLE IV

CANADIAN LIQUID HYDROCARBON EXPORTS
(Thousands of Barrels per Day)

	Canadian Production	Canadian Exports to United States
1951	133	1
1956	476	116
1961	642	187
1966	1,013	372
1968	1,197	501
1969	1,321 (est.)	591 (est.)
1970 (1st Qtr.)	1,639 (est.)	866 (est.)

The future outlook for Canadian liquid hydrocarbons will be influenced primarily by the U.S. supply-demand balance and the oil import program in the U.S. It is generally accepted that the indigenous supply of crude oil and natural gas liquids in the U.S. will not keep pace with domestic demand and that a large potential for imported oil will develop in that nation.

Hope for continued growth in exports of Canadian liquid hydrocarbons to the United States has been strengthened considerably as the result of comments by President Nixon on February 20, 1970, at the time of his announcement that the United States government would put off any changes in the present U.S. Oil Import Control System pending congressional hearings and a review by a new cabinet-level oil policy group. In summarizing the findings of the Schultz Task Force he noted that, "All members also agree that a unique degree of security can be afforded by moving toward an integrated North American energy market. I have directed the Department of State to continue to examine with Canada measures looking toward a freer exchange of petroleum, natural gas and other energy resources between the two countries".

E. UNITED STATES DEMAND

The earlier estimates of U.S. energy and petroleum requirements through 1980 have, almost without exception, demonstrated that forecasters have not allowed for the phenomenal growth in the U.S. market. Following are estimates of U.S. requirements, taken from a number of recent studies.

The striking increases in the forecast requirements for 1980 will be particularly noted in forecasts made during 1969 in comparison with earlier forecasts made during 1967 and 1968. In some instances, current forecasts for U.S. liquid hydrocarbon requirements in 1975 are equivalent to forecasts made in 1967 for the U.S. requirements in 1980.

TABLE V

UNITED STATES PETROLEUM REQUIREMENTS - 1980
(Millions of Barrels Per Day)

Date	Source	1980 Requirement
1965	U.S. Department of Interior	17.5
1966	Pan American Petroleum Corp.	18.6
1967	Stanford Research Institute	18.2
	Syncrude Canada Ltd.	17.2
	First National City Bank of New York	17.2
1968	Petroleum Industry Research Foundation	18.0
	Alberta Oil and Gas Conservation Board	17.8
March	Texas Eastern Transmission	18.8
July	U.S. Department of Interior	18.1
October	Chase Manhattan Bank	18.6
October	Texaco	18.5
November	Arthur D. Little & Associates	19.7
1969	Shell Oil Company[1]	20.3
	Standard Oil Company (New Jersey)[1]	19.3
	Marathon Oil Company[1]	18.6
	Department of Interior - Office of Oil and Gas[1]	18.8
	Cities Service Company[1]	18.8
January	Pan American Petroleum Corp.	18.8
May	Syncrude Canada Ltd.	18.5
May	National Energy Board	19.4
June	Chevron Standard	18.7
September	Alberta Oil and Gas Conservation Board	18.7
October	Foster Associates, Inc.	19.7
November	Oil & Gas Journal	21.0
December	Dome Petroleum	19.2

[1] Based on response to questionnaire of Cabinet Task Force (U.S.) on Oil Import Control, 1969.

F. UNITED STATES SUPPLY

Until recently it had been generally expected that U.S. conventional production, without Alaska North Slope, would increase to some 12 million barrels per day by 1975 and, after a short stable period, would gradually decline. However, the steadily declining level of drilling, the alarming downward trend in crude and gas liquids reserve life index, and the recent disappointing production performance at higher allowable rates in Texas and Louisiana indicate that the oil production in the "lower 48" is near maximum now and that a peak will occur before 1975, possibly at a level slightly above 11 million barrels per day. In order for the U.S. to achieve and maintain domestic production rates between 11 and 12 million barrels per day and, at the same time, retain a reserve-to-production ratio at the current level, an extraordinary level of exploration effort with correspondingly high success ratios would be required. It would be necessary to find the equivalent of Canada's entire current recoverable reserves every two and one-half years; or it would be necessary within a very short period of time to increase U.S. gross additions to reserves by 30 percent above recent experience. Considering these factors, it is evident that a forecast of a stable 11 to 12 million barrels per day domestic production rate, excluding North Slope oil, is optimistic. These views were set forth by the National Energy Board in its 1969 report.

The decreased estimates of U.S. supply have been strongly influenced by the trend of U.S. reserves addition. Proved oil reserves of the U.S. suffered their worst setback in a decade in 1968, according to the annual study made by the reserves committee of the American Petroleum Institute and American Gas Association. Gross additions to petroleum liquid reserves fell 685,000 barrels short of matching record production. The U.S. thus had 10.3 years supply proved entering 1969, contrasted with 10.9 years supply a year earlier and 13.5 years at the end of 1958.

The deteriorating situation with respect to U.S. supply is further evidenced by the estimates of U.S. capacity to produce crude oil and condensate. The Independent Petroleum Association of America began estimating U.S. producibility in 1954 and during 1968, for the first time since 1954, their

estimate of U.S. capacity was reduced from the previous total. Other forecasts indicate that reserve productive capacity in the U.S., excluding Alaska, is evaporating fast. Texas and Louisiana, the only two producing states left with significant extra oil capacity, are beginning to show definite signs of weakness and neither can make as much oil as it could a year ago on the same allowable. According to most observers, unless conditions change markedly in the very near future production in the contiguous 48 states will peak before 1975 at around 11 million barrels per day. Some decline thereafter would indicate that by 1980, when U.S. demand is expected to reach approximately 20 million barrels per day, production from the "lower 48" will be unable to supply much more than 50 percent of U.S. domestic demand.

G. INFLUENCE OF NORTH SLOPE PRODUCTION ON U.S. SUPPLY

The National Energy Board has assessed the Prudhoe Bay discovery on the North Slope of Alaska in its continuing studies on export demand for Canadian liquid hydrocarbons. Dr. R.D. Howland, Chairman of the National Energy Board, in reporting to the Commons Committee on Natural Resources and Public Works in Ottawa on May 11, 1969, stated:

> "Assuming that the U.S. wishes to restrict imports from overseas to present percentage level and maintain its present ratio of reserves to production, it will be necessary for the U.S. to assure itself of some 80-billion bbls of new reserves by 1980.
>
> It is against that figure that one sets the various estimates of the extent of the North Slope reserves in Alaska. These vary from 5 billion to 50 billion barrels, with the probabilities being in the order of 20 to 30 billion.
>
> Our estimates also indicate that by 1975 the U.S. will be consuming some 5 billion barrels of its domestic reserves each year. This figure increases to 5.5 billion to 6 billion bbls by 1980. Thus, Prudhoe Bay at 20 billion may not amount to more than three years of new supply and at 30 billion to no more than five years."

H. U.S. SUPPLY-DEMAND GAP

A number of forecasts of the gap between U.S. domestic supply and demand have been made, particularly in efforts to determine the magnitude

of the export market in the U.S. for Canadian conventional crude oil and synthetic crude oil. However, many of these studies are not current enough to take into account the increased magnitude of U.S. demand or the recently recognized weakness in U.S. domestic supply in the "lower 48". The National Energy Board has approached this problem utilizing different levels of U.S. conventional domestic production and different levels of production from the Alaska North Slope.

Table VI is based on the assumption that U.S. conventional domestic production (without Alaska North Slope) will peak at around 11 million barrels per day before 1975, and that North Slope production will build up to a rate of 3.2 million barrels per day by 1980. The resulting deficiency in 1975 to be filled by overseas imports, conventional crude from Canada and synthetic crude is 4.5 million barrels per day. By 1980 this deficiency has grown to almost 6 million barrels per day, and it increases sharply to more than 9 million barrels per day in 1985.

TABLE VI

UNITED STATES PETROLEUM DEMAND AND SUPPLY[1]
(Millions of Barrels Per Day)

	1968	1975	1980	1985
TOTAL DEMAND	13.4	16.7	19.4	22.5
Less:				
Domestic Production[2]	10.6	10.8	10.3	10.2[3]
North Slope Alaska Production	-	1.4	3.2	3.2
GROSS SUPPLY DEFICIENCY	2.8	4.5	5.9	9.1
Less:				
Imports from Overseas	2.3	2.9	3.4	3.9
MARKET OPPORTUNITY FOR CANADIAN CONVENTIONAL AND SYNTHETIC CRUDE	.5	1.6	2.5	5.2

(1) Source: "Energy Supply and Demand in Canada and Export Demand for Canadian Energy 1966 to 1990" by National Energy Board staff - page 53.

(2) Excluding North Slope Alaska

(3) NEB used 4.0 MMB/D for 1985

It seems clear, according to the National Energy Board study, that in the long range (1980-1990) the United States will experience a large-scale deficiency in supply from domestic sources. It would be necessary for the United States to assure itself of 125 billion barrels of new reserves by 1990 in order to eliminate this deficiency even assuming overseas imports at current rates and Canadian exports at the level of 4 million barrels per day. To find reserves of this magnitude would require annual additions to reserves of 6.25 billion barrels in comparison to current average of 3.3 or 3.4 billion barrels.

I. EXPANSION OF U.S. MARKETS FOR CANADIAN LIQUID HYDROCARBONS

The most recent forecasts dealing with the future United States market potential for Canadian oil are those prepared by the National Energy Board and by Foster Associates. Both reports recognize that the magnitude of this market will depend to a very considerable extent on the policies adopted by each of the governments, after acting jointly or separately. Despite the lack of certainty as to the import policy that the United States will adopt after its current review of the ten-year old oil import control program - and the reaction Canada will have to that program - both reports predict a continued expansion of markets for Canadian liquid hydrocarbons in the United States.

On Table III, the NEB forecasts of Canadian exports to the U.S. (based on the assumption that overseas imports continue at the same percentage of total U.S. demand) are at a level of 1.1 million barrels per day for 1975 and increase to 5.2 million barrels per day in 1985. It should be noted that the 1975 figure could increase substantially if there are further delays in delivery of North Slope production in volume to the major U.S. markets.

Again, it must be emphasized that these forecasts point to the likelihood that Canadian conventional production must be supplemented by a rapid expansion of synthetic crude production from the Athabasca oil sands of Alberta if Canada is to take advantage of these market opportunities.

J. ALBERTA'S PRE-EMINENT ROLE IN CANADIAN LIQUID HYDROCARBONS SUPPLY

The Foster Associates study also looks at Canadian productive capacity, and anticipates that Alberta production will continue to grow but that Saskatchewan and Manitoba production will decline. This forecast is borne out by the indicated response of these provinces to the greatly increased demand for crude oil and equivalent during the first four months of 1970. Total demand for this period, based on nominations for January and February and estimated needs in March and April, averages 1,502,000 barrels per day compared to actual production in the same period last year of 1,205,000 barrels per day - an increase of close to 25 percent.

Alberta, from conventional crude oil, pentanes plus and synthetic crude, will be called upon to supply the bulk of extra demand with nominations averaging 1,190,000 barrels per day for February, an increase of 295,000 barrels per day from refiners' requirements of 895,000 barrels daily during the same month last year. Of the demand for 1,190,000 barrels per day, synthetic crude will supply 36,000 barrels per day, pentanes plus will supply 114,000 barrels per day and the remaining requirement of 1,040,000 barrels per day will be expected to be supplied by conventional crude oil.

Requests for Saskatchewan crudes have been set at 274,000 barrels per day, up from 252,500 barrels per day for February 1969, but the province's actual output is estimated at 255,000 barrels per day with a resulting deficiency of some 19,000 barrels per day expected. British Columbia producers are scheduled for a 10,000 barrel per day hike in production to 79,000 barrels per day, while output from Manitoba will be unchanged at 17,000 barrels per day.

Alberta's Productive Capacity

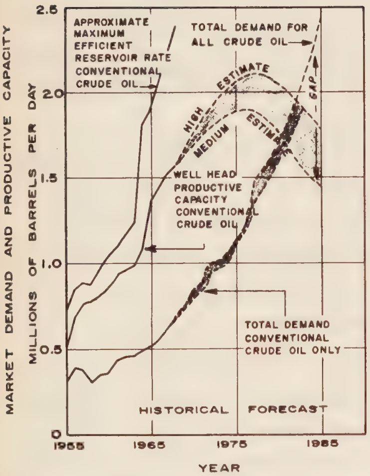
Although the developed wellhead crude oil productive capacity from conventional sources in Alberta was estimated at 1.6 million barrels per day by the Alberta Oil and Gas Conservation Board, the total capacity adjusted for field and processing plant limitations was 1,068,000 barrels per day as of December 31, 1968. When the capacity was then adjusted for limitations due to field and main pipeline facilities within the Province, the effective capacity was further reduced to 890,000 barrels per day. Recent programs to upgrade field production facilities and to arrange pipeline tie-ins will have increased

effective capacity for all conventional crudes to 1,090,000 barrels per day by February 1, 1970. However, in February Alberta will still be almost 80,000 barrels per day short of meeting the unexpectedly high demand requirement for conventional crude oil, primarily due to bottlenecks in the major interprovincial transmission lines.

Alberta could produce more oil than it can sell; the other provinces of Canada, with the exception of Saskatchewan, must import all or a portion of their requirements. Although Alberta can supply a portion of this demand, it unfortunately cannot supply all of these import requirements because of economic considerations. And although areas of the United States provide logical markets for increased volumes of Alberta crude oil, the U.S. is currently undergoing a period of adjustment in which attempts are being made to balance internal and external factors relating to supplies of crude oil, with the result that serious limitations have been placed on the amount of oil that Alberta producers are allowed to sell to the United States. For some time Canadian exports to the United States have exceeded the informal quotas, but the possibility exists that the volume may have to be cut back sharply to stay closer to the U.S. limits.

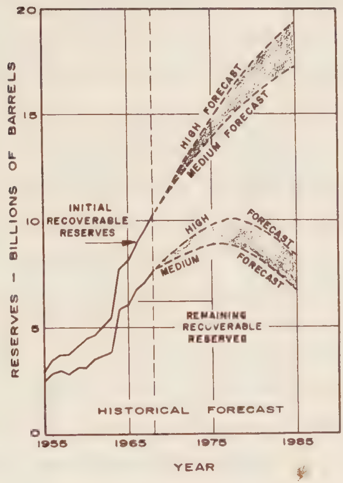
Within a few years, the problem of apparent oversupply will give way to the problem of insufficient oil, at least from conventional sources, to satisfy the growing demand, which has been discussed in an earlier section of this submission. Although the Alberta Oil and Gas Conservation Board estimated that Alberta's maximum efficient reservoir capacity was some 2.4 million barrels per day at the end of 1968, it must be recognized that there is not the developed wellhead or pipeline capacity to handle anywhere near this amount of oil. Furthermore, it would be most unwise to produce at this level for any length of time since it would quickly drop the life index or years of reserve supply for Alberta (and Canada too) well below the recommended minimum level of 12 to 13 years. Assuming that markets were available, Alberta could produce oil at a high rate for a relatively short time or for considerably longer periods at lower rates of production. If an excessively high rate of 2.4 million barrels per day was chosen then major pipeline expansion would be required. Since production at this rate would quickly drop the life index to

Fig. V-8



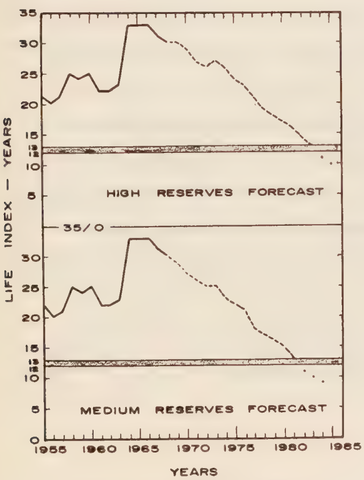
MARKET DEMAND AND PRODUCTIVE CAPACITY FOR ALBERTA CRUDE OIL

Fig. V-9



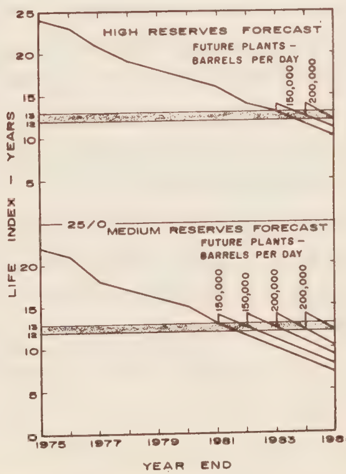
RECOVERABLE RESERVES OF CONVENTIONAL CRUDE OIL IN ALBERTA

Fig. V-10



LIFE INDEX FOR ALBERTA CONVENTIONAL CRUDE OIL WITH PRESENTLY AUTHORIZED SYNTHETIC CRUDE OIL PRODUCTION

Fig. V-11



FORECAST OF ADDITIONAL REQUIREMENTS OF SYNTHETIC CRUDE OIL

8.5 years (according to the Alberta Oil and Gas Conservation Board) production would have to be curtailed. Pipeline companies could not justify a major investment in expanded facilities for this short period - unless Alberta's life index could be maintained at acceptable levels by supplementing the conventional reserves with a rapid expansion of production from the Athabasca tar sands of Alberta.

At the present time, if we include natural gas liquids with crude oil totals, and disregard the effects of insufficient production and pipeline facilities on the assumption that these factors will be improved as markets develop, Alberta could produce in the neighborhood of 2 million barrels per day without dropping below the recommended 12 to 13 years of supply. However, at this production level the oil industry would have to discover an average of about three-quarters of a billion barrels of new proven oil reserves per year just to balance withdrawals, or one-quarter billion barrels more per year than the average finding rate since the Leduc discovery in 1947. To increase the discovery rate by 50 percent will be difficult if not impossible. A more realistic appraisal of the maximum production level for Alberta is now believed to be in the range of 1.5 to 1.75 million barrels per day.

A number of industry economists now believe that by the late 1970s Alberta will have worked off its surplus producing capacity, and that it will be unable to expand production fast enough to accommodate developing markets. With nominations for Alberta oil well above the million barrels per day mark early in 1970, forecasts of the maximum level of Alberta production and the point in time when Alberta will produce at 100 percent of wellhead capacity can be made with increasing accuracy.

On October 20, 1969, at the annual meeting of the Canadian Society of Chemical Engineering in Edmonton, the Chairman of the Oil and Gas Conservation Board of Alberta, Dr. George W. Govier, spoke on Alberta's Oil Sands Development Policy. In discussing future development of the Athabasca tar sands, Dr. Govier stated that studies by the Conservation Board, as shown on Figure V-8, indicated Alberta wellhead productive capacity (the effective maximum productive rate) would peak at around 1.8 million barrels per day

(based on a medium forecast of recoverable reserves additions) between 1976 and 1977; that total demand for Alberta conventional and synthetic crude oil would match Alberta's effective productive capacity in early 1980.

Timing of Further Requirements of Synthetic Crude Oil Production from Alberta's Tar Sands

In the view of the Chairman[1] of the Alberta Oil and Gas Conservation Board, the rapidly increasing demand for Alberta conventional crude, coupled with the Board's forecasts of Alberta's reserve trends, now makes it obvious that substantial volumes of synthetic crude oil production from the tar sands must be available much sooner in order to prevent the decline of the life index below the critical level of 12 to 13 years. The Board's low, medium and high forecasts of Alberta initial conventional crude oil reserves, involving an examination of potential appreciation of reserves in currently existing pools and an assessment of likely levels of future discoveries and their appreciation are shown on Figure V-9. The medium forecast calls for an average annual growth over the period from 1967 to 1980 of 480 million barrels, close to the Board's current calculation of the historical long-term growth rate. In addition, judgment adjustments have been applied to this base forecast to obtain "high" and "low" reserve estimates, with average annual growth for these cases of 600 and 380 million barrels respectively. However, the Board on page 82 of the Oil and Gas Conservation Board Report 69-C stated "it continues to consider the low and medium forecasts most applicable to a life index projection".

The Board's medium reserves forecast, used in conjunction with their increased basic demand forecast, results in Alberta's life index for conventional crude (with presently authorized synthetic crude oil production) dropping to the critical 12.5 years level in mid-1981, as shown in the lower portion of Figure V-10. This calls for additional synthetic crude production of up to 750,000 barrels per day coming on stream between 1980 and 1985. In effect, this means that a new 150,000 or 200,000 barrel per day plant must come on stream

1 Speech by Dr. G.W. Govier, February 18, 1970, Denver, Colorado at Sixth Oil Shale Symposium and Hydrocarbons Symposium (Annual Meeting of the AIME)

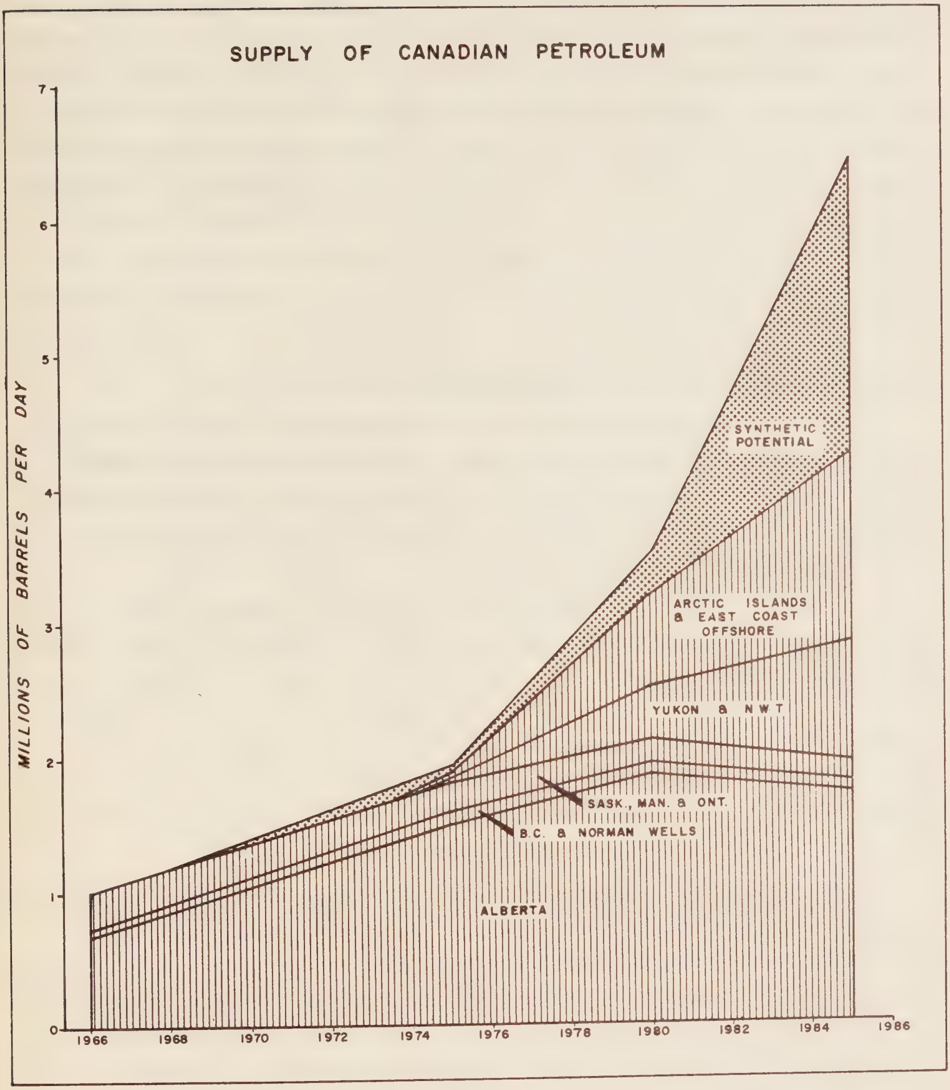
each year from 1981 onward - four plants to be completed between 1981 and 1984, as illustrated in the bottom half of Figure V-11. These forecasts, made in late 1969, serve to demonstrate the growing awareness that U.S. demand in the late 1970s and 1980s will be far greater than envisioned in any of the forecasts made as recently as mid-1968.

There is also the definite possibility that the forecast levels of additional synthetic crude oil production made by the Conservation Board may in themselves substantially underestimate the need - at least the timing of the need. In its determination of the life index for Alberta conventional crude oil production, the Board estimated the demand for Alberta light and medium crude oil at 1,660,000 barrels daily in 1980, increasing to 2,500,000 barrels per day in 1985. In comparison, a forecast by Chevron Standard Limited at the Kaybob South hearing before the Oil and Gas Conservation Board in April, 1969, predicted a 2,111,000 barrel per day demand for Alberta liquid hydrocarbons in 1930; Home Oil Limited submitted a forecast of 2,011,000 barrels per day for 1980; and the forecast levels of 1980 demand by two of the Syncrude Canada Ltd. participants at that time ranged between 1,920,000 and 2,200,000 barrels per day.

If we apply these higher demand rates for Alberta conventional crude to the Board's medium reserves addition case it is apparent that Alberta's life index will reach the 12 to 13 year level in the late 1970s, and application of the higher demand rates to the Board's low reserves addition case could again advance the date by which supplemental synthetic crude oil production over and above current approved permit volumes from the tar sands will be required. And should the volumes of Canadian exports to the U.S. mentioned in the preliminary report by the Staff of the U.S. Cabinet Task Force on Oil Import Policy materialize, the Conservation Board's forecast of commencement dates for further volumes of new synthetic crude oil production would be set forward from 1981 to 1975 or 1976.

The National Energy Board of Canada holds views similar to those expressed by Dr. Govier of the Alberta Oil and Gas Conservation Board. Dr. R. D. Howland, Chairman of the National Energy Board, in testimony in early May, 1969 before the Commons Committee on Natural Resources and Public Works,

Fig. V - 12


SUPPLY OF CANADIAN PETROLEUM
MILLIONS OF BARRELS PER DAY
0
1
2
3
4
5
6
7
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
SYNTHETIC POTENTIAL
ARCTIC ISLANDS & EAST COAST OFFSHORE
YUKON & N.W.T.
SASK., MAN. & ONT.
B.C. & NORMAN WELLS
ALBERTA

stated that on the basis of present supply, the Western Canada Sedimentary Basin could not possibly meet anticipated U S. demand beyond 1980. He indicated it was possible that it could be met as a result of discoveries which might be made in the future in the frontier areas of the North and by development of offshore resources and perhaps the Gaspe Peninsula in Quebec. Apart from these untested regions, he stated that the only source of major increased output would be the tar sands. Dr. Howland did not reply directly to questions as to when more of Alberta's tar sands might come into production, but said it was significant that the same companies which made the Alaskan North Slope discovery are still proceeding with work on synthetic oil production both in Canada and the United States.

K. CANADIAN OPPORTUNITY AND THE U.S. SUPPLY-DEMAND GAP

It is timely to examine the impact of possible new significant discoveries in Canada's frontier areas, and to determine what role they might play in Canada's opportunity to supply a substantial portion of the growing U.S. deficiency - and also to determine whether major discoveries in these areas might inhibit further development of the oil sands of Alberta.

In our forecast of Canada's productive capacity, shown on Figure V-7, it was assumed that significant discoveries would be made before 1980 in the Yukon and Northwest Territories, in the Arctic Islands and in the East Coast offshore. As will be noted on Figure V-12, new production from the Yukon and Northwest Territories is forecast to reach 400,000 barrels per day by 1980 and to increase to 900,000 barrels per day by 1985. And for the Arctic Islands and East Coast offshore, production in 1980 is forecast at 700,000 barrels per day, increasing to 1,400,000 barrels per day by 1985.

The generalized supply-demand relationship shown on Figure V-12 has, for purposes of illustration, portrayed the level of production that may be developed in the Arctic Islands and the East Coast offshore as a part of the supply to be utilized in filling the growth in demand in the market areas now being served by Western Canada conventional liquid hydrocarbons. However, it is generally recognized that Arctic Islands development or discoveries off the East Coast, if of sufficient magnitude, would logically move to fill

some or all of the requirements for crude oil in Eastern Canadian markets and perhaps provide for exports to Europe or the eastern seaboard of the United States. Such a marketing pattern would not displace Western Canadian conventional or synthetic crude in any of the markets which are included in our forecast of "Total Demand for Canadian Petroleum" (Table III), and thus the supply deficiency segment of Figure V-12 labelled "Synthetic Potential" can be expanded to include the volumes of production attributed to "Arctic Island and East Coast Offshore".

Even if all of this additional conventional production could be made available to supplement the production from Canada's current productive areas and from the Northwest Territories, supplemental synthetic crude production would still be needed in large volumes. Our projections show that after 1979 or 1980 the total Canadian productive capacity (including the "frontier areas") will be inadequate to meet both Canada's growing demands on its own domestic production and a greater share of the ever-increasing United States demand. Beyond 1980 the gap between Canadian productive capacity and the markets which could be available to Canadian liquid hydrocarbons widens rapidly. In order for Canada to take maximum advantage of this market opportunity, a rapid expansion of production of synthetic crude oil from the Athabasca oil sands will be required.

APPENDIX VI

COMPETITIVE SOURCES OF LIQUID AND GASEOUS HYDROCARBONS IN NORTH AMERICA

Although North America is relatively well endowed with sources of energy, it is also a large consumer of energy. In the United States the steadily declining level of drilling and the ominous trend in proved crude and gas liquids reserve life index indicate a continually increasing gap between supply and demand. If, as all signs indicate, economical supplies of conventional crude oil and natural gas fall short of demand, the gap will be filled by imports and synthetic hydrocarbons. National security considerations and the balance-of-payments problem preclude complete reliance on imported offshore oil to supplement conventional domestic production with the result that the tar sands, oil shales and coal indigenous to the North American continent will become logical sources of synthetic hydrocarbons.

The trend of reduction in proved reserves life index may have been reversed temporarily by recent discoveries of large crude reserves on the Alaskan North Slope. However, in recent hearings before the Alberta Oil and Gas Conservation Board relative to an application by Syncrude Canada Ltd. for approval of a scheme to produce synthetic crude and specialty oils from the Athabasca tar sands, the Board agreed that even the most optimistic projection of Alaskan production would not fill completely the expected deficiency of production versus demand even when allowing for overland and overseas imports. Recognizing this fact, the Board granted approval for Syncrude Canada to implement their scheme with production to commence in July 1976.

At the present time, the technology of recovery of liquid hydrocarbons from the Athabasca tar sands is some years ahead of oil shale and coal conversion technology. However, delays in additional commercial development of the tar sands may well see this competitive advantage disappear. In the discussions which will follow it will become obvious that

a number of companies are interested in at least two and in some cases all of the sources of synthetic liquid hydrocarbons. This would indicate that as yet no one of the sources has a clear-cut advantage. Those differences in the economic climates under which these resources will be developed may well determine which of the synthetic fuels develops at the fastest rate.

A. COLORADO, UTAH AND WYOMING OIL SHALES

The U.S. Geological Survey estimates that the Colorado, Utah, and Wyoming shale deposits contain reserves of approximately 2 trillion barrels of oil equivalent in shale richer than 10 gallons per ton, with 80 billion barrels considered recoverable by present technology.

Interest in the extraction of oil from the U.S. oil shale has been intense for a number of years. Several development projects have already been completed and new ones are now underway. As a point of interest, one of the participants in the Syncrude Canada Ltd. project has invested more money in the United States oil shales than it has in the Athabasca tar sands.

The United States Congress has recently recognized the need for and provided endorsement of added incentives for development of oil shale. The tax bill recently passed by both Houses of Congress, and signed into law by the President does not change the 15% rate of depletion on oil shale but places the point of allowed depletion at the retorted products rather than the mined oil shale. This essentially doubles the depletion allowance on oil extracted from shales and improves the economics of shale oil production relative to conventional petroleum (which suffered a reduction in depletion percentage) and other synthetic hydrocarbons.

Anvil Points Project

Private industry has attacked oil shale development problems through several separate projects. In the Anvil Points project, six companies co-operated in an extended research program into oil shale mining and retorting using facilities leased from the U.S. government. The Department of the Interior in May of 1964 leased its facilities at Anvil Points to Colorado School of Mines Research Foundation, Inc. This foundation performed research under contract to Mobil Oil, Humble Oil and Refining, Continental Oil, Pan American Petroleum, Phillips Petroleum and Sinclair Research.

Extensive test work on mining, crushing and retorting was carried out during Stage I of this project. By the time this stage had been completed in April 1966, the companies had spent $2.7 million. At this point, they agreed to increase the projected outlay for Stage II from $3 million to $4.5 million. Results obtained from the two small retorts utilized in Stage I led to modification of the government's 150 ton per day retort and runs at this facility began in November 1966. Retort operation ceased in August 1967 and the research work of Stage II was completed in early 1968. Results of this work are not yet available; however, a publication regarding the achievements of Stage I indicated that 80 - 85% of the organic values in crushed and sized oil shale could be recovered as oil and gas by the process investigated.

Colony Development Company Project

During the period 1964-1967 there was considerable activity on the part of the Colony Development Company, a corporation created by Standard Oil Company of Ohio, Cleveland Cliffs Iron Company, and The Oil Shale Corporation in April 1964 to act as their agent for development of mining and retorting systems for oil shale.

The Colony Development Company initially began operation of a room-and-pillar oil shale mine and a 1000 ton per day prototype TOSCO process retort in early 1965. TOSCO is the familiar name for The Oil Shale Corporation, a publicly held company which was founded in 1955. Its principal purpose was the development of a commercially feasible, above-ground retorting system for the economical recovery of oil and other products from the oil shales of the western United States. They developed a patented process utilizing heated ceramic balls for the retorting of shale oil. By November 30, 1964, TOSCO had expended $5,350,000 for operations and an additional $1,600,000 for acquisition of suitable oil shale reserves for a total of $6,950,000. At the same date it was committed to spend another $8,500,000 for reserve acquisitions and in furtherance of its production project.

In the initial stages of this program extreme difficulties were experienced with breakage of ceramic balls used in the process. However, after a period of experimentation with various formulations of ceramic balls, this problem was brought under control and TOSCO is now confident of the economic viability of the process.

Colony Venture

At the end of 1968, Colony was restructured to include Atlantic Richfield Company as a participant in the reserves and technology formerly held by Colony Development Company. With Atlantic Richfield as operator, the Colony Venture participants are actively pursuing a new research program aimed at solving the remaining problems with the TOSCO process, gathering additional information on shale mining, and determining the true cost of building and operating a synthetic crude oil plant. In this effort, the mine and 1,000 ton per day retort at Parachute Creek, Colorado, will be utilized to determine projections for a commercial scale venture.

In Situ Methods

In situ retorting has the tremendous appeal and potential advantage that no material handling other than of raw shale oil would be necessary, and that there would be no problem of disposing of spent shale. In addition, an in situ process would be entitled to 22% depletion allowance instead of the 15% depletion allowance for mining-retorting projects.

In situ work done to date has involved fracturing the shale by electrical, chemical or hydraulic means prior to the application of heat, or operation in special horizons in the formation which possess adequate native permeability.

Sinclair Research used hydraulic fracturing to obtain inter-well communication and then employed downhole burners to initiate in situ combustion to heat the formation. In 1961 Mobil Oil conducted an in situ experiment along similar lines. Equity Oil Company is now field testing a process employing the injection of hot natural gas to retort the shale.

The most unorthodox proposal for in situ retorting is that contemplating the use of atomic explosives for fracturing. A joint feasibility study and contract negotiation effort involving the U.S. Bureau of Mines, the U.S. Atomic Energy Commission and twenty-four oil and mineral companies was carried out over a period of several months. Among them were: Atlantic Richfield Company, Cities Service Oil Company, Ashland Oil and Refining, Continental Oil Company, El Paso Natural Gas, Equity Oil, Getty Oil, Marathon Oil, Mobil Oil, Pan American Petroleum, Shell Oil, Sinclair Oil and Gas, Sohio Petroleum, Sun Oil, Tenneco Inc., Cleveland Cliffs Iron, Superior Oil, Union Pacific Railroad, Western Oil Shale, and Texaco, Inc. The concept envisions creation

of huge underground chimneys of fractured shale as a result of buried atomic explosions. Heat would then be applied and the resulting crude oil pumped out.

The Atomic Energy Commission is extremely enthusiastic about this project and have stated that this method might recover 160 billion to 320 billion barrels of oil estimated to be locked up in the more deeply buried oil shales in the Piceance Basin of western Colorado. The technical feasibility and potential profitability of the method have been questioned severely and the effort is presently in limbo.

The United States Bureau of Mines has been active in research supporting the concept of nuclear fracturing of oil shales followed by retorting of the chimneys thus created. Toward this end, a 150-ton batch retort has been constructed to simulate the rubble created in a nuclear cavity. This facility is currently being operated to project operating conditions and expected yields from a fractured chimney of oil shale. These results will, no doubt, form the basis for future efforts to promote nuclear fracturing technique tests.

Another, more conventional, fracturing technique has been applied recently in shallow and comparatively thin oil shale beds in the Green River formation of Wyoming. The U.S. Bureau of Mines applied conventional explosives (nitroglycerine) to fracturing a thin bed of shale which had previously been drilled in a closely spaced pattern of development wells. Subsequent ignition of the formation around a central well confirmed communication had been created to certain peripheral wells and some shale oil was produced from the formation. The technique is still being evaluated for possible commercial significance.

Other Research Projects

The Denver Research Institute announced on November 10, 1965, the formation of the Centre for Fundamental Oil Shale Research. An initial program of three years duration was completed. Funds for the initial program were provided by the Shell Development Company, The Oil Shale Corporation, the Aquitaine Oil Corporation, Humble Oil and Refining Company and the University of Denver. A second three year program has been initiated under the

sponsorship of Shell, the Oil Shale Corporation, Atlantic Richfield Company, Humble, and the University of Denver. The TOSCO and Atlantic Richfield sponsorships are on behalf of all the Colony Venture participants. Fundamental studies into the nature of kerogen and its transformation into useful products will be continued in this program.

Laboratory experiments have also demonstrated that several other processes such as the high temperature hydrogen processes, developed by Texaco, Inc. and Petrochemical Corporation, are feasible.

General

Oil shale has certain advantages over tar sands as a source of synthetic crude in that it is native to the country representing the market and is much closer to the market; also it has an advantage relative to coal in that much less hydrogen is required per barrel of product of comparable quality. The level of research activity on oil shale continues high and alternate possibilities for improved shale oil extraction are being explored.

B. PROCESSES FOR LIQUEFACTION OF COAL

An immense amount of work has been done on coal conversion to oil, particularly through the Office of Coal Research of the United States Department of the Interior. Liquefaction became an obvious goal of coal research many years ago since coal is energy in a most inconvenient form, despite its abundance and its low price in many locations. The extensive coal reserves in the United States and Canada and advances in technology for conversion of coal to liquid products may make coal a first choice in the search for a new source of liquid fuels if political obstacles continue to impede commercialization of both oil shales and tar sands.

With the development of economic hydrogenation processes, reductions in the cost of hydrogen, and the presence of a satisfactory differential between the price of coal and that of liquid fuels, it appears that commercial conversion of coal to liquid fuels will be in operation in the United States sometime between 1975 and 1985. Mr. Neal P. Cochran of the Office of Coal Research confirmed this thought when he stated on February 21, 1967 in a

speech at the A.I.M.E. Annual Meeting in Los Angeles, that he felt both liquid fuels and pipeline gas from coal will be in commercial production by 1975, and at the same meeting Mr. Cochran and Mr. Walter R. Hibbard of the U.S. Bureau of Mines predicted that gasoline could be produced from coal in the 10 cent to 13 cent per gallon range. With this in mind, it is not too difficult to understand the reasons for the statement by Mr. J.K. Jamieson, Chairman of the Standard Oil Company of New Jersey, that "we will see commercial production from shale oil or coal within the next ten years".

Coal hydrogenation to manufacture synthetic liquid fuels was practiced during World War II in England and Germany. These processes were uneconomic under peacetime conditions. In recent years however, the economics of coal hydrogenation have been improved through development of improved catalysts' system which have reduced operating pressure, thereby reducing investment and operating costs. Other approaches to deriving liquids from coal by pyrolysis rather than hydrogenation have been demonstrated. These techniques have the advantage of reducing hydrogen requirements and thereby reducing the cost per barrel of product. However, these processes produce large amounts of solid, low-volatile char and must be used in conjunction with the need for fuel of this type, such as large steam electric plants. The U.S. Bureau of Mines has been testing the burning characteristics of coal char in a small unit and if by-product char possibilities are confirmed, the potential of producing competitively priced gasoline by coal pyrolysis will be enhanced.

Project Gasoline

The largest coal liquefaction project now under way is being performed under contract to the Office of Coal Research by the Consolidation Coal Company, a subsidiary of Continental Oil Company. Both companies had been working for a number of years on the basic development of a coal-to-gasoline process. During the course of the laboratory work, a new catalyst system was developed which promises to reduce the cost of gasoline below that originally predicted. Early in 1965, on the basis of an evaluation of all work to date by both the Office of Coal Research and by the Ralph M. Parsons Company, retained as a consultant and monitor of the project, a

contract was executed between Consolidation Coal Company and the Office of Coal Research for construction of a $5.5 million pilot plant at Cresap, West Virginia. Efforts to bring the plant on stream have continued since May, 1967.

From the work to date it has been estimated that a 48,000 BPD gasoline plant could produce gasoline at a cost of 15.5 cents per gallon with a return on investment of 6.4%. The process has also been evaluated as a means of producing synthetic crude oil. The price of producing synthetic crude oil at a rate of 250,000 BPSD from western United States coal has been estimated at $3.25 per barrel, assuming a 6.4% return on investment. No value was assumed for the char produced but if a value based on 80% of the price of coal of equivalent heating value were assumed, the crude oil price would be reduced to $3.15 per barrel.

The pilot plant operations are continuing for further development of the process. Successful completion of the program will provide sufficient data to permit the process to be applied commercially in most of the major oil producing areas of the United States.

H-Coal Process

Hydrocarbon Research, Inc. has developed a process, trade-named the H-Coal Process, to convert coal to a light crude oil suitable for a gasoline feedstock. The development was furthered by a project, beginning in February 1965, sponsored by the Office of Coal Research. The Atlantic Richfield Company has been sponsoring continued development with HRI since March 1968. Bench-scale work, confirmed by operations at a pilot plant processing about 3 tons of coal per day, has produced higher yields than thos originally predicted. Pilot plant operations have demonstrated the operability of the process through achieving many runs of several weeks duration.

Under contract to the Office of Coal Research, the American Oil Company in 1967 made an independent economic evaluation of the H-Coal Process in which the price of gasoline from a 100,000 BPSD gasoline refinery was estimated at 12¢ per gallon, assuming an 18% annual charge for capital before taxes.

In the H-Coal Process the coal is dried, pulverized and slurried with coal-derived oil for charging to a coal hydrogenation unit. The coal-oil slurry is charged continuously with hydrogen to a reactor containing an ebullating bed of catalyst. The coal is hydrogenated catalytically and converted to liquid and gaseous products. Nearly 90 weight percent of the moisture and ash-free coal is converted. The synthetic crude oil produced in the H-Coal step requires additional processing to produce specification gasoline and furnace oil. More or less conventional refinery operations are suitable for these upgrading steps. The work to date indicates that a proposed refinery would yield 4 barrels of synthetic crude per ton of moisture and ash-free coal. This yield excludes propane and butane which, if recovered, would provide an additional 0.4 barrels per ton of dry coal.

Project Seacoke

A third method of conversion investigated was Project Seacoke, the work being performed by the Atlantic Richfield Company under contract to the Office of Coal Research. This process has possibilities in areas where large coal-fired electrical generating plants and oil refineries already exist in a local area, in that it has the potential of substantially increasing coal demand in existing markets without requiring new marketing channels or large accumulations of capital for new "grass roots" plants. The process would "top off" the coal in an adaption of the present oil refinery fluidized coking process. The topped off fractions of the coal are converted to gasoline and the char, still a large part of the original coal, continues to the power plant to serve as fuel. The process has been demonstrated to be technically feasible since coal has been topped and char produced in bench-scale fluidized cokers. The final report on this project will be issued soon by the Office of Coal Research.

Project COED

The fourth and oldest project undertaken by the Office of Coal Research for the liquefaction of coal is Project COED, carried out under contract by the FMC Corporation. The original objective of this project was to develop a process to produce a liquid product from coal which then could be mixed in with residual char and both transported to market by pipeline, but insufficient

liquids were produced to slurry the char to a central plant. After investigating several alternatives, the project efforts evolved a multistage fluidized bed pyrolysis. (Pyrolysis is the heating of coal in the absence of air). A process development unit with a capacity of about 100 pounds of coal per hour was successfully operated throughout most of 1965 and 1966. Commercially feasible yields of oils, gases (both hydrogen and fuel gas) and char were obtained from various coals in this unit. An analysis based on these data indicates that a plant for producing a synthetic crude oil, fuel gas and solid char-fuel from coal using the COED process could be built to process 3.5 million tons of Utah coal per year, and would maintain a 13 to 25% return on investment before taxes. This estimate is based on the following prices: coal, $3.00 per ton; synthetic crude oil, $4.00 per barrel; and fuel char, 90% of coal value.

Further development of this approach is continuing with operation, beginning in May 1970, of a 25-ton per day pilot plant to prove the technical feasibility of the process on a large scale. This approach may be commercially feasible when the liquefaction plant is located adjacent to an electric utility stream plant.

General

Coal has distinct advantages over the tar sands or oil shales as a prime source of alternative fuel. First, large coal reserves are close to the consumption centers in the United States and will have a further advantage over tar sands in that they will not have to contend with import quotas in gaining access to United States markets. Second, coal provides a liquid yield of up to 3-1/2 barrels of synthetic crude oil per ton of ore, in comparison to indicated oil shale and tar sand yields of less than one barrel per ton of ore. Third, naphtha fractions derived from coal and subsequently reformed can produce 100 Research octane quality gasoline without requiring the addition of lead. Since lead-free gasolines may be mandatory in the future to meet air pollution restrictions, this factor may greatly enhance the attractiveness of coal liquefaction projects.

C. GASIFICATION OF COAL

Although synthetic gas from coal does not compete directly with synthetic oil from tar sands, oil shales and coal, the development effort centered toward commercialization of these processes is worthy of mention. The Institute of Gas Technology's Project Hydrogasification and the Consolidation Coal Company's CO_2 Acceptor Process are the two main processes now actively being developed in the United States. Since the cost associated with producing hydrogen represents a very large part of the overall cost of synthetic gas, major efforts are being made to lower the cost of hydrogen produced from solid fuel. All synthetic oil processes use considerable amounts of hydrogen; therefore, if these efforts are successful, they will, in turn, have a substantial impact on the economics of synthetic crude production.

APPENDIX "D"

NAME: SYNCRUDE CANADA LTD.

SUBJECT: Three Year Tax Exemption
Depletion Allowance

Analysis of Appendix "C" by Senior Advisor

This Brief is submitted by Syncrude Canada Ltd., a management company formed to develop production of crude oil from the Athabasca tar sands in Northern Alberta. The participating interests in the project and rights are as follows:

10% Gulf Oil Canada Limited

30% Imperial Oil Limited

30% Cities Service Athabasca Inc.

30% Atlantic Richfield Canada Ltd.

The Brief points out:

(1) $30M has been spent to date and if the project proceeds, further expenditures of between $250M and $300M will be required for the construction of a plant and electric generating facilities. (Page 1 of the Introduction)

(2) Based on current projections, the Syncrude tar sands project is only marginally economic. (Page 4 of the Introduction)

(3) Syncrude cannot commence production until 1976 because of restrictions in its permit. (Page 5 of the Introduction)

(4) Final assessment of the project will be made in 1973, after considering the tax climate and its effect on net investment yield. (Page 5 of the Introduction)

(5) The United States has recognized the importance of the development of "oil shales" by increasing the depletion available to taxpayers mining oil shale. (Page 5 of the Introduction)

(6) Some resources, including tar sands, involve risks not related to exploration but rather to development and exploitation. Incentives for the development of such a resource cannot be provided by a depletion allowance related to the expenditure of exploration dollars. (Pages 6 and 7 of the Introduction)

(7) The adverse economic effect of discontinuing the existing three year mining exemption and changing the present depletion provision will almost certainly kill the Syncrude project. (Page 7 of the Introduction).

The Brief states that the public interest with respect to development of the Athabasca tar sands will be best served by retention of the present depletion allowance and three year mining tax exemption. (Page 8 of the Introduction)

There is attached the usual summary of present tax laws, White Paper proposals and principal points of the Brief.

Name: SYNCRUDE CANADA LTD.

Date Brief Received:

Principal Subject: Three Year Tax Holiday

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83-5 of the Income Tax Act This section provides that income for three years after commencing operation of a mine is exempt from tax.	5.31 Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines. 5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.	Page 5 of Introduction The introduction to the Brief points out that under terms of its permit, production cannot be commenced until 1976, and that a decision has only to be made in 1973 whether to proceed or not. Page 4 of Introduction The Brief points out that the project is marginally economic. Page 6 of Introduction The Brief sets out that the proposed rapid write-off of certain fixed asset costs does not compensate or make up for the loss of the three year mining exemption.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		<u>Pages 7 and 11 of Introduction</u> The Brief points out the adverse economic effect of discontinuing the existing three year mining exemption, and the resulting loss to the development of the remote and impoverished areas of Northern Alberta. <u>Page 12 of Introduction</u> The Brief sets out the economic benefits to be obtained if the project proceeds. <u>Page 8 of Brief</u> The Brief submits that the present three year tax exemption should be retained. <u>Page 2 of Summary</u> Alternatively, if the present three year tax exemption is to be changed, it should be retained for the Athabasca tar sands.

Name: SYNCRUDE CANADA LTD.

Date Brief Received:

Principal Subject: Depletion - Operator

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Part 12, Section 1201 of the Income Tax Regulations This section provides for a 33-1/3% depletion allowance, based upon net profit from the operation of the resource.	5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is 33⅓ per cent. Special rates of depletion are provided for gold and for coal.	Pages 6 and 7 of Brief This portion of the brief points out the economic effects that would follow if the present depletion allowance is cancelled. With respect to depletion, it points out: (1) The United States has recognized the importance of the development of "oil shales" by increasing the depletion available to taxpayers mining oil shale. (Page 5 of the Brief, also Appendix IV) (2) The concept of earned depletion has limited application to the Syncrude project because there is no "exploration" as such to do. The Athabasca tar sands represent a resource, the existence and location, of which is and has been known for many years.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	(3) The concept of earned depletion provides tax incentive only to the kind of resource development that requires risks to be taken in exploration activity. Some resources, including of course the tar sands, involve risk that is not at all related to exploration but to development and exploitation. Incentive for the development of that kind of resource is not provided by a depletion allowance that is related to the expenditure of exploration dollars. Page 8 of Brief The Brief submits that the present depletion allowance should be retained. Alternatively, if the present depletion is to be changed, then by exception it should be retained for the Athabasca tar sands project.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example: Profits before eligible expenditures $6,003 Deduct eligible expenditures 3,000 3,003 Maximum depletion $1,001 (1/3 of $3,003) Earned depletion (1/3 of $3,000) 1,000 Taxable income $2,003 5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.	

APPENDIX "E"

March 1, 1970.

Brief of the

Canadian Potash Producers Association

to

The Standing Senate Committee on Banking, Trade & Commerce

and

The House of Commons Committee on Finance, Trade & Economic Affairs

re

The Federal Government's White Paper on Taxation

Summary

The potash industry in Saskatchewan, now consisting of nine operating mines with one about to come into production, has been developed in less than a decade with a capital investment of little less than $700 million. Companies were encouraged to undertake these operations, which have become of major importance to the Province of Saskatchewan, and to the general economy of Canada, under the incentive tax provisions now in force; provisions which have been a major factor in the growth of the Canadian mining industry since the end of World War II.

It is now proposed in the White Paper that these incentive tax provisions be drastically modified or abolished.

If these Proposals are carried through, very serious injury will be done to the potash industry, which is now in a precarious condition owing to abnormally low prices and a demoralized market.

The principal Proposals are:

1. the abolition of the three year tax exemption for a new mine, substituting in its place a provision for rapid write-off of certain initial capital expenditures; and

2. the abolition of the depletion allowance, which has been on the statute books since 1917, to be replaced by a system of "earned depletion"; i. e. $1 of depletion will be earned for $3 of exploration expenditures for new mines.

As regards 1, this is not of current and direct concern to potash operators, all of whom have benefited, or are eligible to benefit, from the 3 year tax exemption period. On the other hand this provision is of great importance to the mining industry in general and has resulted in the development of many mines which would not otherwise have come into existence. The rapid write-off of certain initial expenditures may be of some benefit, but such expenditures would be written off anyway through capital cost allowances.

As regards 2, this is extremely serious for long-term mining operations. To make depletion wholly dependent on exploration for new mines ignores the original and primary purpose of the depletion allowance and is highly discriminatory between different segments of the mining industry. Under the Proposals no potash mine would quality for depletion.

The purpose of the depletion allowance is to recognise the "wasting asset" character of a mining operation and to provide companies with some reserve of capital for mine development. This principle is recognised in the tax law of the United States and other countries. Canadian potash companies took depletion into account in their original feasibility studies, and its retention and continuance are essential if the industry is to achieve any degree of profitability and to maintain its position in export markets, where currently it earns some $60 million annually in foreign exchange.

If the Proposals are carried through in their present form we anticipate the following results:

1. Mining companies, being subject to provincial taxes or, as in Saskatchewan provincial, royalties as well as federal income tax, will pay a higher rate of tax than other industries; the effective rate will be from 57 to 60% compared to the 50% rate paid by other industries;

2. A decline in capital investment, both domestic and non-domestic, in mineral exploration and mine development.

3. A decline in the profitability of mining companies with serious adverse effects on Canada's export trade:

4. The overall decline in mining activity will be accompanied by a parallel decline in those service and secondary industries which mining promotes and sustains, with adverse effects on employment;

5. A loss of potentially valuable mineral resources, as increased costs relegate to waste rock what would otherwise be economically recoverable ore;

6. A disincentive to regional development which is one of the principal aims of the federal government; this is particularly true of the Province of Saskatchewan, where the potash industry is a factor of growing economic importance.

7. A deterrent to capital accumulation, without which industrial growth is impossible, and

8. A diversion from Canada to other countries of mining capital, both domestic and non-domestic.

For these reasons it is our firm belief the Proposals should be rejected.

Brief March 1, 1970.

re

The Federal Government's White Paper on Taxation

submitted by the
Canadian Potash Producers Association

To: The Standing Senate Committee on Banking, Trade and Commerce
and
The House of Commons Committee on Finance, Trade and Economic Affairs.

Gentlemen,

The purpose of this brief is to analyse and assess the impact of the federal government's Proposals, as set forth in the White Paper on Taxation, upon one segment of the Canadian mining industry, namely those companies engaged in the production of potash.

The Canadian Potash Producers Association represents all potash producing companies in Canada, a list of which is attached to this brief as appendix 1.

Appendix 2 gives a short summary of the rapid growth and development of this industry, which, while of comparatively recent origin, has already become an important and significant factor in Canada's mineral production and its export performance.

Unlike any other segment of the Canadian mineral industry its activities are confined to a single province, the Province of Saskatchewan, in the economy of which it now plays a major role.

The Proposals advanced in the White Paper are of particular concern to potash producers and their effect, if implemented, would be especially severe.

The industry is still in its comparative infancy. It is struggling with serious problems of over supply, low prices and keen competition for North American and overseas markets. These circumstances call for constructive encouragement, not penalizing deterrents.

For the extractive industries as a whole the White Paper Proposals have a double impact, general and particular.

As regards the general impact, your committee will be receiving many submissions, so that it is not our purpose to deal with this aspect of the White Paper in any detail. We refer here to such Proposals as the broad shift of the major burden of taxation from the lower income brackets to the middle income brackets; the capital gains tax at high rates of unrealized, as well as realized, capital gains, a strong deterrent to capital accumulation on which industrial progress depends, and in general a tax climate less favourable to domestic and non-domestic investment; these and many other aspects of the tax Proposals will have been brought forcefully to your attention.

While we share the concern very generally felt by Canadian industry in relation to these aspects of the Proposals, our brief will be primarily directed to those sections which relate specifically to mining operations, and particularly the potash industry.

The enormous growth of the Canadian mining industry in general and the development of whole new segments such as iron ore and potash in recent years have been in large part attributable to a favourable tax climate and to specific tax incentives granted to mining operations. It has been recognised not only in Canada but throughout the mining world that the growth of Canadian mining, with vast economic benefits to the country as a whole, has been nurtured and encouraged by such tax provisions.

It is now proposed that these be radically modified or eliminated.

The case for incentive tax legislation extended to mining operations, in view of such factors as an unusually high rate of financial risk, the usual remoteness of the operations and often unusual responsibilities for creating new communities and communal facilities, and so forth, is generally recognised. It is acknowledged in the White Paper itself in the following terms (section 5. 24);

"The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation. It is recognised that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases. Consequently, special arrangements are desirable...... Secondly, it is recognised that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating and maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts........ The government feels the exploration for and development of minerals still warrant some support in a form more directly related to this activity than has been the case with past depletion. It is believed that support on a less generous scale should suffice for this purpose."

The two major changes proposed relate to the three years tax-exemption for a new mine and the depletion allowance.

As regards the former, the three year tax-exemption for a new mine, it is proposed that this be abolished after December 31st, 1973, and that instead a new mine be permitted a fast write-off of its exploration and development expenditures and the cost of mining machinery and equipment. "Taxpayers (section 5. 31) can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment".

While this Proposal may look reasonable enough on paper, it is, in effect, a drastic reduction of the incentive currently afforded. It offers nothing except a quicker write-off of certain capital expenditures which would in any event be recaptured through depreciation. The three year tax exemption of a new mine is not in itself a matter of great concern to potash producers; they have all received it or are eligible to do so. But it was a factor of some importance in their original feasibility studies.

It is true of mining in general that many mines which have developed to substantial proportions would never have been undertaken in the absence of this provision. It does offer an incentive to develop Canada's mineral resources, and, with the increasing consumption of minerals and metals throughout the world, the countries which have the potential and proceed to develop such resources, will increase their prosperity and economic strength.

Depletion allowances, in Canada and in the United States, have long been a matter of some controversy.

In the United States different percentages of depletion rate are applied to different minerals, and the principle of the depletion allowance has been retained in the recent revision of U. S. tax law.

The Canadian practice, since 1917, has been to allow a mining operation to reduce its taxable income by exempting from tax 33 1/3 per cent of profits (with special arrangements for gold and coal). This is a substantial incentive and has long been recognised as one of the principal factors in the industry's growth. It has enabled companies to plow back a good proportion of profits into mine development and mineral exploration.

It is now proposed (White Paper, sections 5. 36 to 5. 42) to discontinue this system after 1975, and instead to substitute a plan of "earned" depletion, i. e. a depletion allowance will be granted only to the extent to which a company devotes expenditures to mineral exploration in search of new mines. The formula proposed is that for every $3 of eligible expenditures the taxpayer would earn the right to $1 of depletion allowance.

Companies not engaged in off-property mineral exploration will receive no depletion allowance at all.

At first and superficial glance this Proposal would appear to be an inducement to encourage mineral exploration. On closer analysis it is seen to be sharply discriminatory, and fails to meet the conditions for which a depletion allowance was instituted.

Some mining companies are by the nature of their organisations committed to broad and continuing mineral exploration. Others are concerned with only a single metal or mineral, e. g. gold, iron ore, asbestos or potash. Where, as in the case of potash, abundant supplies and reserves are known to exist there is no point in conducting exploration programmes, and any inducement to do so completely misses the mark.

Potash companies will forfeit any claim to depletion allowance.

It is, in our view, a fundamental error and wholly unwarranted to make the depletion allowance completely contingent and dependent on exploration expenditures. The justification for a depletion allowance is that it recognises in practice the "wasting asset" nature of mining an ore body.

The depletion allowance has also been an important factor in enabling Canadian companies to develop properties and to sell their products at competitive costs on world markets.

The abolition of depletion, which the Proposals amount to in the case of potash mines, would reduce their ability to produce and sell their product competitively on world markets at world prices.

For this reason, if for no other, we urge that the retention of depletion at the existing level is essential.

Off-property exploration should be fully deductible against other taxable income as an added incentive to stimulate exploration activities for mining companies equipped to conduct them. But there should be no reduction in depletion on producing properties.

Our conclusion can only be that the White Paper proposals do not in fact live up to the government's stated intention of granting special encouragement to the mining industry. They would have the opposite effect; the so-called incentives are illusory.

If the White Paper proposals are implemented without modification we foresee the following results:

1. Mining companies will pay a higher rate of tax than other industries. Mining companies are subject to provincial taxes or royalties. The combination of these with federal tax would amount to an effective rate of 57 to 60% compared to the 50% rate applicable to other industrial companies. This is a penalty and a deterrent;

2. A decline in capital investment, both domestic and non-domestic, in mineral exploration and mine development;

3. A decline in the profitability of mining companies with serious adverse effects on Canada's export trade.

4. The overall decline in mining activity would be accompanied by a parallel decline in those service and secondary industries which mining promotes and sustains, with adverse effects on employment;

5. A loss of potentially valuable mineral resources, as increased costs relegate to waste rock what would otherwise be economically recoverable ore;

6. A disincentive to regional development, which is one of the principal aims of the federal government: this is particularly true of the Province of Saskatchewan, where the potash industry is a factor of growing economic importance.

7. A deterrent to capital accumulation without which industrial growth is impossible, and

8. A diversion from Canada to other countries of mining capital both domestic and non-domestic.

The heavy investments made to bring the potash industry into being were predicated on the current tax provisions; any severe modifications of these, as proposed in the White Paper, will unquestionably result in an indefinite postponement of the industry's ability to realize its economic potential, will constitute an added burden to the Province of Saskatchewan, and substantially reduce an important factor in Canada's export trade and its foreign exchange earnings. It is difficult to conceive that such is the intention of the federal government.

If some modifications of the current system are felt to be necessary, these should be worked out in close consultation with those who are most familiar with the special circumstances and conditions which attach to mining, and who have had long practical experience of what is feasible.

We sincerely trust, gentlemen, that your review and study of the White Paper Proposals will lead you to agree that substantial modifications of the Proposals are essential if an important Canadian industry is not to be gravely injured.

Respectfully submitted,

V. C. Wansbrough
Executive Director
C. P. P. A.

CANADIAN POTASH PRODUCERS ASSOCIATION

Appendix 2.

The Potash Industry in Saskatchewan.

The potash industry in Saskatchewan is a development of the 1960's. The existence of very extensive potash deposits underlying the midwestern provinces had been known to geologists for many years; but it was not until the late 1950's that supply and market conditions warranted the costly attempt to reach them and bring them to development.

The first operation was undertaken by the Potash Company of America in 1959; but difficulties arising from water seepage postponed production, which was resumed in 1965.

The International Minerals and Chemical Corporation brought their first mine into production in 1962 and a second mine in 1965. These were followed by Kalium Chemicals Ltd., (solution mining) in 1964, Duval Corporation in 1967, the Allan Mine (U. S. Borax, Texas Gulf Sulphur and Swift Corporation) in 1967 and Alwinsal (Potash Company of Canada) in 1968.

More recently mines have been opened by Cominco Limited and Noranda Mines Limited, while the Sylvite mine of Hudson Bay Mining and Smelting Company is due to begin production late in 1970.

The net effect of this rapid and massive development has been to place Canada in the third rank of world potash producers, following the United States and the U. S. S. R. If and when all mines are operating at full rated capacity, output will be in excess of 7 million tons annually.

Each of the ten mines in or ready for production will have cost between $60 to $80 million of capital expenditure. During this brief period little short of $700 million will have been expended in the development of the potash industry in Saskatchewan.

Canadian production in 1969 amounted to 3 million tons of product, valued at $67 million. Domestic consumption accounts for about 8 per cent of the total. The balance is exported, two-thirds finding a market in the United States. Japan is the next largest customer, followed by the United Kingdom.

In less than a decade potash production has become a major economic factor in the Province of Saskatchewan and already plays a significant role in Canada's export trade.

Appendix 1.

CANADIAN POTASH PRODUCERS ASSOCIATION

List of Member Companies

January 1, 1970.

Cominco Limited,
Montréal 2. Québec.

Duval Corporation,
Houston. Texas 77002,
U. S. A.

International Minerals & Chemical Corporation,
Skokie. Illinois 60076,
U. S. A.

Kalium Chemicals Ltd.,
Denver. Colorado 80206,
U. S. A.

Noranda Mines Limited,
Toronto 1. Ontario.

Potash Company of America,
Denver. Colorado 80202,
U. S. A.

Potash Company of Canada Limited,
Toronto 1. Ontario.

Sylvite of Canada Ltd.,
(Hudson Bay Mining & Smelting),
Toronto 1. Ontario.

Texas Gulf Sulphur Company,
Moab. Utah 84532,
U. S. A.

U. S. Borax & Chemical Corp.,
Los Angeles. California 90005,
U. S. A.

In other respects also it has contributed to industrial growth. The industry gives direct employment to some three thousand (3, 000) persons, not a great number in an urban area, but very important in the rural districts of a prairie province. With family dependants and others whose employment is indirectly dependent on the potash industry, it affords a livelihood to possibly five times that number. Through the purchases of machinery, equipment, supplies and services the potash industry is a stimulus to Canadian business and other industries. This is particularly significant as regards transportation, as almost all Canadian overseas sales of potash, as well as substantial quantities to the southeastern States of the U. S. A. , are channelled through the ports area of Vancouver, some 900 miles from the mines.

Unfortunately the growth of Canadian output has coincided with a sharp decline in world prices which have been more than cut in half during the last two years. In an attempt to stabilize a deteriorated and demoralized market the Government of Saskatchewan has adopted a system of rationed production, effective January 1st, 1970, by which producers are limited on a quarterly basis to between 60 and 40 per cent of rated capacity. The first indications are that this measure will contribute to the firming of prices and the restoration of a more orderly market; but it is anticipated that some years will be required before a proper balance between supply and demand is attained and prices rise to a more normal and a profitable level.

In these circumstances it is obvious that any increase in the weight of taxation will deal a severe blow to an industry which is already in a precarious condition. The adverse effects will be felt not only by the producing companies but by the economy of Saskatchewan, with multiplying effects throughout Canada.

APPENDIX "F"

NAME: THE CANADIAN POTASH PRODUCERS ASSOCIATION

SUBJECT: Three Year Tax Exemption Depletion

Analysis of Appendix "E" by Senior Advisor

This Brief is submitted by The Canadian Potash Producers Association, an association of eleven companies, being all the potash producing companies in Canada, and entirely located in the Province of Saskatchewan.

The brief deals with two subjects:

(1) The three year tax exemption, and

(2) Depletion.

The Committee's attention is drawn to the following points made in the brief:

(1) The potash industry in Saskatchewan has developed in less than a decade with a capital investment of nearly $700M. Companies were encouraged to undertake these operations under incentive tax provisions now in force. (Page 1 of the Summary)

(2) To make depletion wholly dependent on exploration for new mines ignous the original and primary purpose of depletion allowance and is highly discriminatory between different segments of the mining industry. (Page 2 of the Summary)

(3) Under the proposals no potash mine would qualify for depletion. (Page 2 of the Summary)

(4) Canadian potash companies took depletion into account in their original feasibility studies, and its retention and continuance are essential if the industry is to achieve any degree of profitability and to maintain its position in export markets, where currently it earns some \$60M annually in foreign exchange. (Page 2 of the Summary)

(5) The industry is still in its comparative infancy. It is struggling with serious problems of over supply, low prices and keen competition for North American and overseas markets. (Page 1 of the Brief)

(6) The three year tax exemption of a new mine is not in itself a matter of great concern to potash producers; they have all received it or are eligible to do so. But it was a factor of some importance in their original feasibility studies. (Page 3 of the Brief)

(7) The depletion allowance of 33-1/3% has been a substantial incentive and it has enabled companies to plow back a good proportion of profits into mine development and mineral exploration. (Page 4 of the Brief)

(8) Companies not engaged in off-property mineral exploration will receive no depletion allowance at all. (Page 4 of the Brief)

(9) Potash companies, concerned with a single mineral, and having abundant supplies and reserves, have no need to conduct exploration programmes. (Page 4 of the Brief)

(10) The abolition of depletion, which the White Paper proposals amount to in the case of potash mines, would reduce their ability to produce and sell their product competitively on world markets at world prices. (Page 5 of the Brief)

(11) Canadian production of potash in 1969 amounted to 3 million tons valued at $67M, of which 8% was consumed domestically and the balance exported.

In conclusion the brief recommends that the proposals of the White Paper referred to in the brief should be rejected.

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: THE CANADIAN POTASH PRODUCERS ASSOCIATION

Date Brief Received:

Principal Subject: Three Year Tax Holiday

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83-5 of the Income Tax Act This section provides that the income for three years after commencing operation of a mine is exempt from tax.	5.31 Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines. 5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.	Page 3 of the Brief This portion of the brief points out: The proposal to replace the three year tax holiday with a fast write-off of its exploration and development expenditures and the cost of mining machinery and equipment may appear reasonable at first glance. However, (a) it is a drastic reduction of the incentive currently afforded (b) it offers nothing except a quicker write-off of certain capital expenditures which would in any event have been allowed as a deduction through depreciation.

Name: THE CANADIAN POTASH PRODUCERS ASSOCIATION

Date Brief Received:

Principal Subject: Depletion - Operator

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Part 12, Section 1201 of the Income Tax Regulations This section provides for a 33-1/3% depletion allowance based upon net profits from the operation of the resource.	5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is 33⅓ per cent. Special rates of depletion are provided for gold and for coal.	Page 4 of the Brief This portion of the brief points out: It is a fundamental error and wholly unwarranted to make depletion allowance completely contingent and dependent on exploration expenditures. The justification of a percentage depletion allowance is that it recognizes in practice the "wasting asset" nature of an ore body.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief

Tax Reform Proposals

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

APPENDIX "G"

SUBMISSION REGARDING

The White Paper
Proposals for Tax Reform

APRIL, 1970
VANCOUVER, B. C.

CONTENTS

A. BETHLEHEM COPPER CORPORATION LTD. ("BETHLEHEM" OR "THE COMPANY")

We are convinced that our company would not have been placed into production without the incentives available in the present Income Tax Act. In this section we submit a brief history of the company, explain why the incentives were required, and offer statistics to illustrate that Bethlehem's production decision was to a great extent determined by those incentives.

B. REASONS FOR TAXATION INCENTIVES TO THE CANADIAN MINERAL INDUSTRY

The White Paper acknowledges the need for tax incentives for the mineral industry without explanation. In this section we have attempted to provide some information to support this acknowledgement.

C. RECOMMENDATIONS CONCERNING THE WHITE PAPER PROPOSALS

In our opinion, the White Paper proposals, if adopted, would have a more serious effect on the mineral industry and on the Canadian economy than was intended when the proposals were drafted. Many paragraphs, although probably not specifically intended to increase the taxation burden of mining companies and their shareholders, will in fact result in increasing that burden.

In this section we offer recommendations for revisions of those proposals of the White Paper that are causing concern to our company and to our shareholders.

BETHLEHEM COPPER CORPORATION LTD.

A. THE COMPANY

Bethlehem was incorporated in February, 1955 for the purpose of exploring and developing a group of mineral claims in the Highland Valley area of British Columbia. Certain of the mineral claims were placed into production as an open-pit mining operation in December, 1962. The initial mill capacity of 3,300 tons per day has been gradually expanded to its present capacity of approximately 14,500 tons per day.

Financing the Company

Since its inception, the financing of Bethlehem proved difficult because of the marginal nature of its properties, and the requirement of the investors to have their capital repaid within a period of time which would not have been possible had it not been for the three year tax exempt period.

The first financing was obtained from American Smelting & Refining Company (Asarco) in the amount of $1,250,000. However, as the results of exploration continued to prove only a marginal property, Asarco was unwilling to finance subsequent developments. The company then solicited the capital markets of Canada and the United States but was unable to raise the funds required to continue its exploration programs.

It was not until the Japanese demand for concentrates began to mount that the company was able to finalize its financing. In 1960 Bethlehem became the first company in Canada to attract substantial Japanese capital to invest in the Canadian mineral industry when the Sumitomo Companies advanced funds to finance an underground exploration program and a mining feasibility study. On the basis of the feasibility study, the Sumitomo Companies advanced to Bethlehem sufficient funds to place the Highland Valley properties into production. Sumitomo's total investment amounted to $5,850,000 (U.S.).

Importance of Tax Incentives

The feasibility study prepared to justify the economics of placing the company's Highland Valley properties into production was completed by Wright Engineers in January, 1961. Although removal of the tax incentives was not being considered at that time, paragraph 8 of page 1-1 of the report begins **"Our interpretation of the figures tabulated in the economic section of the report (Section XI) is that the tax exemption period allowed is the Key to the planning of this project."**

We have reworked the calculations as contained in the Feasibility Study, substituting the White Paper proposals for the tax calculations contained therein. **These recalculations prove that Bethlehem would not have been placed into production if the White Paper proposals had been legislation at that time for the following reasons:**

1. Contrary to the stated intention in the White Paper, **the investment would not have been recovered before the company became taxable.** The company could not have obtained financing because of the very long period needed to recover the investment.

2. Within two years after the date it would have become taxable, the company would have been required to pay taxes on mining income at the rate of approximately 55%. This high rate results from the fact that the company would have been required to pay British Columbia Mining Taxes in addition to Income Taxes, and all eligible earned depletion

would have been previously applied. **The 55% combined tax rate would apply to profits before depreciation.** If the company reported earnings pursuant to the accepted accounting principal of applying depreciation at a lesser rate than capital cost allowance claimed, **the tax rate would have been considerably higher.** This situation would arise from the fact that all Class 10 assets would have been written off.

Economic Justification of Bethlehem

In the deliberations leading to the decision to develop Bethlehem's mining property, the present tax incentives played a vital part. Those proponents of the White Paper, who would advocate and argue for abandonment of a mining property that could not be brought into production without the incentives in the present Income Tax Act, should see in Bethlehem's successful operation ample evidence for rejection of this contention. Without the incentives offered in the present Income Tax Act, no financial interest, operating in a competitive and attractive money market, could have been induced to invest development capital in Bethlehem's property; consequently, the Highland Valley area could not have made its substantial contribution to the wealth of Canada.

In an article published in the December 4, 1969, issue of the Northern Miner (Appendix A) the Hon. T.A. Crerar, who is considered the father of the three year tax exempt period for new mines, explains that the introduction of the incentive was justified because of the "fertilizer" effect that the revenues and expenditures of a mining company have on the community as a whole.

To support this theory, we offer the following statistics.

During the 7 year period from the start of production, Bethlehem has:

- introduced in excess of $100,000,000 in U.S. funds to the economy of B.C. and Canada by sale of its concentrates,
- expended $54,000,000 in purchasing production services and supplies,
- expended $15,000,000 on capital expenditures,
- expended $4,000,000 in exploration in Canada directly and through subsidiary companies,
- included in the above expenditures were $11,000,000 paid to employees as salaries and wages,
- paid $15,000,000 in direct income and provincial mining taxes in addition to federal and provincial sales taxes, municipal taxes, gasoline taxes, etc.,
- paid $12,500,000 in dividends to its shareholders,
- gained the confidence of investors as indicated by an increase in the market value of its shares from $2.20 to $21.00 per share.

For the year ended February 28, 1970, we expect the following results:

- $29,000,000 in U.S. funds will be received from the sale of concentrates,
- expenditures of $13,000,000 for production supplies and services, including
  - expenditures of $1,000,000 for exploration,
  - payroll expenditures of $3,500,000,
- expenditures of $2,000,000 for capital assets,
- direct income and mining taxes of $6,500,000,
- dividends of $2,600,000.

All of the revenues listed above were received in British Columbia and the major portion of the expenditures were made in that Province.

The company has encouraged its employees to establish residence in the Village of Ashcroft. At the time Bethlehem went into production, the only industries in the Ashcroft area were a canning factory which has since ceased operations, a few small lumber companies, all but two of which have ceased operations, and some cattle ranches. Since commencing production, Bethlehem has constructed 100 apartment and townhouse units and has spent a total of $2,150,000 in purchasing residential property and constructing housing accommodation for its employees. In addition, the company has made substantial contributions to recreational facilities, municipal services, the Village hospital and roads in the area.

A very important result of Bethlehem's production decision is that the Highland Valley has become world renowned as a major copper mining area with millions of dollars being spent on exploration and development. At this time one other company is committed to production at a cost in excess of $100,000,000, and at least four others are conducting feasibility studies to ascertain if production is economically justified. Our company, in conjunction with Valley Copper Mines, is studying the economics of bringing into production on their joint properties a mine that would be the largest in Canada, and would cost in excess of $250,000,000 to equip for production. The White Paper Proposals for taxation will be a major factor for consideration in all of these feasibility studies.

It is impossible to measure the total economic impact of Bethlehem's production decision on the Highland Valley region, the surrounding areas of Ashcroft and Kamloops, the Province of British Columbia and Canada as a whole. We know that since Bethlehem came into production, many millions of dollars have been spent on exploration and development of other low grade properties in all areas of British Columbia and several have been brought into production.

B. REASONS FOR TAXATION INCENTIVE TO THE MINERAL INDUSTRY

The Costs and Risks of Exploration

The White Paper, in several references, acknowledges the costs and risks of exploration, but does not attempt to measure them.

An article written for the September 1969 issue of Mining Engineering by Frederick C. Kruger and entitled 'Mining: A Business For Professionals Only', contains statements and statistics that assist in evaluating the costs and risks of mineral exploration. Some quotations from that article are set out below:

Risks – "In the period 1939 to 1949, the U.S. Government Strategic Minerals Development Program examined 10,071 prospects. The San Manuel Copper Co. is the single existing product of that undertaking.

– Texas Gulf Sulphur flew 15,000 miles of airborne geophysics during the period 1959 to 1965. Several thousand anomalies were detected of which several hundred were inspected. Some 60 were drilled. Only one mine resulted.

– D.R. Deny in 1967 stated that of 150 mines started or restarted in Canada since 1955, over 50% were discovered before 1950 and nearly 20% before 1920.

– More than 7,000 mining companies are registered in Canada. Nearly 1,000 are quoted on various stock exchanges. Since 1956, between 51 and 69 have paid dividends in any one year. The Northern Miner says that 0.8% of all incorporated mining companies pay dividends. Most fail to find a mine, but expend exploration funds which add to Canada's employment and Gross National Product.

– Economist, Lee E. Preston, is quoted as stating: "The total real costs of finding a new deposit typically exceed the total return."

– If the chances of discovering a property in any one year are 1 in 10, then the possibility of not making a find in 10 years is 35%. After 22 years of consistent effort the probability is 10% that no find is made.

– In the two years that followed the spectacular discovery of gold at Giant Yellowknife, N.W.T., some 300 mining companies took up the search in a 150 mile radius. Despite earnest endeavour over the succeeding 19 years, only two mines were found."

Costs – "J.D. Bateman estimated that among professional exploration groups $7.5 million was the cost of finding one mine.

– W.S. Kirkpatrick of Cominco estimated that in Canada the "annual expenditure on exploration was $38 million in 1960, $43 million in 1963 and $45 million in 1964". These efforts resulted in the discovery of about one and one-half mines per year. In other words it currently costs the industry about $30 million to find one mine."

– Over the last 15 years exploration expenditures have increased sevenfold, while new ore found has increased only two to threefold."

Since it commenced production, Bethlehem has spent $4,000,000 directly on exploration or in financing subsidiary exploration companies without discovering any other ore bodies outside it's original Highland Valley properties.

We believe that because of the risks inherent in the exploration for minerals, capital can only be attracted if the expectations of high rewards for successful discoveries are present. The White Paper acknowledges that there will be a reduction in investment if the proposals are adopted. The above quoted article contains statistics which indicate that producing mining companies spend only .1 to 1.0% of their total sales on exploration. Thus the major share of exploration activities are conducted by non-producing smaller exploration companies which already find it difficult to attract risk capital and the withdrawal of the existing incentives can only compound these difficulties and materially lessen exploration activity upon which the future of the Canadian mineral industry is dependent.

Capital Cost of Equipping a Mine for Production

The cost of equipping a mine for production can vary materially depending to a large extent on location and method of production.

The high grade and easily accessible mines in western and northern Canada have apparently been found and mined. The industry has largely turned to the development of sizeable low-grade deposits which in many cases are located in remote regions.

The mining of low-grade deposits has only become feasible with advances in technology which allow for low-cost handling of large volumes of material by open pit methods. However, the capital costs of this type of operation are enormous. As an example, a company which recently announced a production commitment for its Highland Valley properties, has an indicated capital cost of $3,000 per ton day of rated mill capacity.

In more remote locations where the required facilities can include townsites, schools, hospitals, roads, power-lines, railroads, airports, docks, etc., the cost per ton day of rated mill capacity can exceed $10,000 as is the case of a recently developed mine in the Yukon.

By the nature of the operations these enormous costs must be incurred at one time and in this way the mineral industry differs from most other industries which can commence operations with a small capital investment and expand when volume of sales demands it.

The Wasting Nature of Mineral Deposits

Minerals once extracted can never be replaced. Most industries are financed and placed into production on the assumption that they will continue forever with increasing acceptance and sale of their products. Conversely, a mining company commences production with the knowledge that its operations will come to an end **at some predictable future date**. Therefore revenues earned by mining companies must be regarded, at least partially, as a return of capital invested.

Under our present Income Tax Act, a depletion allowance is deductible in calculating taxable income to allow this return of capital invested. Although the White Paper proposes to eliminate this depletion allowance, the theory is still accepted in other countries, such as the United States and Australia, with whom Canada competes for mineral investment capital.

Every mining company in British Columbia, and in Canada, can calculate the approximate date when its ore reserves will be exhausted.

In Appendix B, we have totalled the published ore reserves of 23 British Columbia mining companies, which we believe represents the major portion of the operating mines or mines that are committed to production, and by dividing these ore reserves by normal annual production, we have calculated the dates when these ore reserves will be exhausted.

Unless new mines are discovered, or new ore reserves are proven on existing mining properties, the mining industry of British Columbia will come to an end within 30 years.

This Province and this country face a major economic adjustment if new mines do not continue to be found and placed into production. We cannot accept without concern Mr. Benson's statements that

> "The tax reform proposals set forth in this paper are expected to have relatively modest impacts upon the Canadian economy apart from the effects on savings in closely-held companies **and possibly on investment in the mining industry"** (Paragraph 8.35) or —
>
> "No doubt there would be some marginal projects abandoned or deferred in the next several years" (Paragraph 8.48).

International Aspects of the Mineral Industry

Mineral exploration funds flow to those regions of the world that show the greatest rewards for discovery. Recent discoveries in Australia, Mexico and other regions of the world have attracted substantial amounts of exploration and development funds, much of it Canadian. As pointed out previously, Canada may be at a competitive disadvantage because of its increasing dependence on development of low grade deposits. In addition, severe climatic and geographic conditions in the northern regions of this country increase the cost of exploration and development of mineral properties. The mineral industry in Canada has displayed remarkable growth in spite of these factors. This growth must, in large part, be attributed to the incentives offered by the present income tax legislation, primarily the three year tax exempt period for new mines and the depletion allowance. It should be noted that both of these incentives are related to the taxation of mining companies after they have reached production. Incentives offered by other countries also are related to decreasing the taxation burden after the mine has been placed into production, such as —

- In Ireland, a 20 year tax free period,
- In Australia, 20% of mineral income is exempt from taxation and a fast write-off of assets is allowed,
- In the United States, a generous percentage depletion allowance.

The White Paper has made a serious judgement error in attempting to relate the incentive of earned depletion to exploration. Mining companies regard exploration as an unavoidable expenditure that must be incurred to continue existence. They will continue to expend funds on exploration regardless of the tax treatment of those expenditures. The location of these exploration expenditures however, will depend upon the rewards that are offered for successful exploration. Mining companies incur exploration expenditures to continue in existence, not to earn tax credits.

The Efficiency of the Present Incentives

Paragraph 1.5 of the White Paper states; "The mineral industries enjoy special benefits that have existed for many years but that are unnecessarily costly and inefficient."

In other areas of this submission, we discuss the cost of the incentives, so our comments in this section will deal only with their alleged inefficiency.

The purpose of incentive legislation is to encourage investment and development, particularly in the more remote regions of the country.

Recently the British Columbia Mining Association commissioned an independent firm of Chartered Accountants to conduct a study of the "Growth and Impact of the Mining Industry in British Columbia."

The results of that study are remarkable and obvious evidence of the efficiency of the existing incentives. The following are extracts from that study and are shown in detail in Appendices C to H:

Appendix C — Shows that the net capital inflow to the Mining Industry of British Columbia has increased in ten years from $18,000,000 in 1959 to $180,000,000 in 1968.

Appendix D — Shows that total exploration and development expenditures have increased from $6,000,000 in 1959 to $39,000,000 in 1968, excluding an estimated $22,000,000 spent by exploration companies who were not members of the B.C. Mining Association. It should be noted that expenditures in 1967 and 1968 were considerably less than in 1965 and 1966, a situation which may have been caused by reaction to the Carter report.

Appendix E — Illustrates the application of exploration and development expenditures during the ten years ended 1968 between the population divisions of the Province.

Appendix F — Illustrates the growth in investment in capital expenditures by the mineral industry in the 10 year period.

Appendix G — Shows the investment in capital expenditures by population division.

Appendix H — Illustrates the allocation of manpower of mining companies during 1968 by population divisions of the Province. In 1968, the B.C. mineral industry employed 10,500 persons directly and paid $92,000,000 in wages and employee benefits.

The study also shows that in 1968, the mineral industry of British Columbia earned $302,000,000 in revenues from sale of mineral products, $265,000,000 of which was generated from export sales.

It is apparent that the incentives have been efficient in promoting overall growth and in encouraging development of the more remote and less populated areas of British Columbia.

C. RECOMMENDATIONS CONCERNING THE WHITE PAPER PROPOSALS

Three Year Tax Exempt Period

The White Paper proposes to eliminate the three year tax exempt period for new mines and substitute a fast write-off of certain mine assets. In the preceding paragraphs, we have illustrated the need for incentive legislation to attract mineral investment to Canada. The tax exempt period is primarily responsible for the outstanding growth record of the mineral industry in Canada, and we disagree with the statement made in the White Paper that the incentive has been unnecessarily costly. For many years, Canada has introduced incentive legislation including direct subsidies to attract industry to the remote and depressed regions of the country. None of the legislation has been as successful as the tax exempt period for new mines, and none has been less costly. An exempt period, unlike a subsidy, only rewards successful operations. The indirect taxes — sales tax, gasoline taxes, property taxes, employee taxes — generated by bringing a new mine into production substantially offset the revenue loss.

The fast write-off of assets proposed by the White Paper must be recognized as a postponement of tax, not an exemption. It will result in an excessive taxation burden on the industry after the assets are written off. Although the stated intention of the fast write-off proposals is to ensure that the investment is recovered before taxes are incurred, the assets eligible for write-off have been limited to the machinery and buildings acquired to exploit a new mine, completely ignoring the substantial costs incurred by mining companies in constructing townsites, roads, railroads, power lines, etc. These costs will not be recovered, under the proposals now advanced, before taxes are paid. In our opinion, it is a completely inadequate incentive to attract the capital investment required to sustain the growth of the industry in Canada.

If the integration of company and shareholders taxes, as proposed in the White Paper, is adopted, the revenue loss represented by the tax free period is substantially reduced. Shareholders will not be able to claim creditable tax on dividends received out of profits earned by a mining company during the tax exempt period. Therefore there would be no revenue loss from a closely held company, and even in a widely held mining company the major portion of the taxes that would have been paid by the company will be collected from the shareholders when profits are distributed by way of dividends.

This may be illustrated as follows:

	Closely Held Corporations		Widely Held Corporations	
	Tax Exempt Period	No Tax Exempt Period	Tax Exempt Period	No Tax Exempt Period
Income of corporation before tax	$ 100.00	$ 100.00	$ 100.00	$ 100.00
Corporate Tax if applicable	—	50.00	—	50.00
Dividend to shareholders	100.00	50.00	100.00	50.00
Add creditable tax	—	50.00	—	25.00
Taxable to shareholder	$ 100.00	$ 100.00	$ 100.00	$ 75.00
Shareholders tax (assume 50%)	$ 50.00	$ 50.00	$ 50.00	$ 37.50
Less creditable tax	—	50.00	—	25.00
Combined Corporate & Shareholder Tax	$ 50.00	$ 50.00	$ 50.00	$ 62.50
Revenue Loss caused by Tax Exempt Period	Nil		$ 12.50	

Although the revenue loss is minor, as illustrated above, the tax exempt period has been considered by many to be too generous an incentive for those higher grade mineral properties where risk is substantially reduced.

We would therefore recommend that the tax exempt concept be retained, but the exempt period would end at the expiration of three years, or when the mining company has earned profits equal to its investment in exploration and development, whichever event occurs first. For purposes of calculating exempt income, investment in capital assets should include investments in townsites, roads, dams, power lines, etc., in addition to mine assets. After expiration of the exempt period, capital assets and exploration expenses would be eligible for normal write-off as is permitted under the present Income Tax Act.

Depletion Allowances

The present Income Tax Act recognizes the wasting nature of mineral deposits by allowing percentage depletion for most mines of 33-1/3% with special rules for coal and gold mines. It must be recognized that, because of Provincial Mining Taxes, the present percentage depletion only reduces the effective tax rate for mining companies by approximately 8% from the rate paid by most other industries. British Columbia mining companies (other than coal and gold mines) pay combined Income and Provincial Mining Tax of 42% compared to the 50% rate applicable to other industries.

Canada, and in particular British Columbia and Northern Canada, is competing with other countries for mineral investment capital. Other countries, including the United States, are offering percentage depletion as an incentive. The American position in this regard has recently been confirmed.

The White Paper proposals do not offer an incentive to acknowledge the wasting nature of mineral deposits. The proposals offer what is termed "earned depletion". This "earned" depletion will allow a deduction of $1 from taxable income for each $3 expended on exploration, development, or to acquire mining buildings and equipment for the exploitation of a new mine.

The example below illustrates the effect of this proposed change in the depletion incentive on a producing B.C. mine that has not expended funds on exploration.

	Present Tax Laws	White Paper
Assuming income of	$ 100.00	$ 100.00
B.C. Mining Tax	12.75	12.75
	87.25	87.25
Depletion Allowance	29.08	–
Taxable Income for Federal Purposes	$ 58.17	$ 87.25
Tax at 50%	$ 29.08	$ 43.63
Total Tax Burden		
Income Tax	$ 29.08	$ 43.63
B.C. Mining Tax	12.75	12.75
	$ 41.83	$ 56.38
Percentage of Income	42%	56%

This example illustrates an increase in effective tax rate of 35% for B.C. mining companies by the change in the depletion incentive alone. It also illustrates that a B.C. mining company could be required to pay taxes at a rate at least 6% higher than the rate paid by other industries, some of which receive incentives or subsidies which serve to reduce their effective tax rate below 50%.

Equity demands that the effective taxation burden of a mining company cannot exceed that of other Canadian industries (50%). If, as the White Paper states is the intention, an incentive is to be offered, it must result in a taxation burden below that of other Canadian industries and comparable to that paid by the mineral industry in other countries with which Canada competes for investment capital. We believe that these two objectives can be achieved by any of the following methods:

(a) Continuation of the percentage depletion allowances, but with some minor adjustment of rates having regard to depletion allowances in other countries competing with Canada for mining capital. It must be remembered, however, that the percentage must exceed 16% in order to reduce the tax burden below 50%.

(b) Allowing Provincial Mining Taxes to be deducted from Income Taxes **plus** a smaller percentage depletion allowance. In this circumstance a 16% depletion allowance would result in the 42% effective tax burden now being paid by mining companies. It should be pointed out that the major portion of Provincial Logging Taxes are at the present time deductible from Income Taxes, and the White Paper does not propose any change in this method of treating Logging Taxes.

(c) Allowing Mining Taxes as an offset against Income Taxes or percentage depletion to reduce the effective tax burden to 50% **plus** "earned" depletion to reduce the burden below that rate. We believe that this is the least favourable of the three recommendations because it relates the incentive to exploration, a concept that we do not accept and it does not offer an incentive comparable to that offered in other countries.

The White Paper provides a transitional period of 5 years to make the change from a percentage depletion concept to an earned depletion concept. During this period a producing company will be allowed to claim percentage depletion and to build up "earned" depletion credits for application after expiration of the 5 year period. For some unexplained reason, the White Paper has restricted the transition provisions so that they apply only to mineral properties owned prior to the date the White Paper was introduced. As explained in the following section, mineral acquisition agreements often require mineral properties to be transferred to a newly incorporated company when they are brought into production. We believe that this limitation on percentage depletion will restrict the transfer of properties prior to the expiration of the 5 year period, and may in some cases delay production decisions. We cannot understand why property ownership as at November 7th, 1969, should have any bearing on the method of calculating taxable income of mining companies, and we recommend that the percentage depletion be available to all mining companies during the transitional period.

Prospectors and Mineral Claims

The proposal to tax proceeds from sale of mineral properties may result in serious administrative problems. Quite often, a prospector will receive shares, or the promise of shares, of a new company as the only consideration for his mineral properties. These shares are normally not marketable and are without value until the property has been explored. If, in spite of this fact, a value is assigned to the shares in order to collect tax on the proceeds of sale of the mineral properties, the prospector may be forced to dispose of a portion, or all, of the shares in order to pay the tax. We believe that it is inequitable that a prospector be forced to dispose of his shareholding before the potential has been evaluated.

The type of agreement referred to above, where shares are exchanged for mineral properties, has proven to be the most satisfactory from the standpoint of the purchaser and the seller. The seller continues to share the risk during the evaluation period, but has the chance of considerably greater reward if the

property proves economical. Adoption of the White Paper proposals would force at least sufficient cash to pay the prospector's taxes to be included in the consideration for the properties. Because the consideration will have to be established before the property is evaluated, this will always result in the prospector receiving too little, or the company paying too much, for mineral properties. The inclusion of cash as a consideration will also give an advantage to large, well financed mining companies to acquire mineral properties.

In many instances, Canadian Securities legislation requires that the shares a prospector receives for his mineral properties be held in escrow and not sold until their release is authorized by the relevant Securities Commissions. We believe that this requirement is a necessary precaution to protect the investing public. However, if the White Paper proposals are adopted, some revisions will be required in this legislation to enable the prospector to realize on at least sufficient shares to pay his tax before his prospect is proven commercial, which will be at the expense of the investors.

On November 7th, 1969, the date the White Paper proposals were presented, many prospectors had signed agreements that gave mining companies the option to acquire their properties at some future date. The purchase price of the properties had been established on the premise that the proceeds would be non taxable. If the options are not exercised prior to implementation of the White Paper proposals, at least part of the proceeds will be taxable. We recommend that the proceeds from sale of mineral claims received pursuant to an agreement signed prior to November 7th, 1969, be exempted from taxation.

The White Paper proposes to gradually introduce the taxation of mineral properties, taxing 60% of the proceeds in the first year after implementation and increasing the taxable portion by 5% for each subsequent year. The proposals do not provide for the deduction of costs in establishing the taxable portion. We submit that, if the proceeds are to be taxed, the acquisition costs be deducted in calculating the taxable portion of proceeds and that during the transition period, when a percentage of proceeds is taxable, the same percentage of cost be allowed.

A major portion of the producing mines in Western and Northern Canada are still discovered through the efforts of individual prospectors. In the past, prospectors have been exempt from taxation on amounts received from sale of mineral properties. The White Paper proposes to eliminate this exemption, but to allow mining companies to deduct the costs of acquiring mineral properties when calculating taxable income. The White Paper fails to recognize the extent of the dependence of the mineral industry on prospectors efforts, and that the motivation for prospecting must always be a promise of substantial reward. It is becoming increasingly difficult in our modern society to find individuals willing to accept the personal sacrifices and risks of failure inherent in prospecting. We recommend that the White Paper proposal to tax the proceeds of sale of mineral properties be rejected.

Dividends of Mining Companies

Under the present Income Tax Act, shareholders receiving dividends from Canadian mining companies are allowed to deduct a portion of the dividend in recognition that, due to the wasting nature of mineral deposits, the dividend is a partial return of capital.

The percentage varies between 10% and 20%, depending on the amount of non-mining income earned by the paying company. This shareholder depletion allowance results in shareholders of mining companies paying slightly less tax on their dividends than shareholders of other industries.

The White Paper proposes to eliminate the depletion allowance to shareholders of mining companies as well as the 20% dividend tax credit available to shareholders of all Canadian companies. Shareholders of Canadian companies will be allowed to claim a portion of the taxes paid by the corporation as an offset against their personal income taxes.

This integration procedure will result in a substantial reduction in the total combined corporate and shareholder tax burden for most Canadian industries with the exception of the mineral industry. This

reduction in total tax burden is illustrated in the graph in Appendix I. The White Paper has ignored the effect of Provincial Mining Taxes on the total taxation burden of mining companies, and of their shareholders. The graph attached as Appendix I illustrates that the total taxation burden of producing mining companies and their shareholders under the integration proposals will not only be greater than at present, but will be greater than that of other industries.

The examples used in the illustrations in the above paragraph have ignored the effect of the White Paper Proposals for "earned depletion" and fast write-off of assets of a new mine on the creditable tax available to mining company shareholders. The following table illustrates the effect of earned depletion on taxes a shareholder will pay under the integration proposals.

	Present System	White Paper Proposals
Corporate Income before depletion	9,000	9,000
Depletion at maximum rates	3,000	3,000
Taxable Income	6,000	6,000
Tax at 50%	3,000	3,000
Net Corporate Income	6,000	6,000

	Shareholder Marginal Rate 30%	Shareholder Marginal Rate 50%	Shareholder Marginal Rate 30%	Shareholder Marginal Rate 50%
Shareholder Dividend	6,000	6,000	6,000	6,000
Less 20% depletion	1,200	1,200	—	—
Add Gross Up	—	—	1,500	1,500
	4,800	4,800	7,500	7,500
Tax at Applicable Rates	1,440	2,400	2,250	3,750
Less dividend tax credit 20%	960	960	—	—
Creditable Tax	—	—	1,500	1,500
Shareholder Tax	480	1,440	750	2,250
Percentage Increase			56%	56%

The preceding two paragraphs show that Canadian investment in the mineral industry will be discouraged by the adoption of the integration concept. As the White Paper proposes to limit the creditable tax concept to Canadian resident shareholders, this increased taxation of the mineral industry will have a lesser effect on the foreign shareholder. There are strong feelings in Canada about Canadian ownership of natural resources, but the White Paper integration proposals appear to encourage foreign ownership.

The White Paper would require that profits of Canadian Corporations be passed to shareholders within two and one half years in order that shareholders may claim the creditable tax. We have indicated in earlier sections of this submission the substantial cost that must be incurred by mining companies in exploring and developing new mineral prospects. In most instances, a substantial portion of these costs must be

financed from working capital. We believe that the requirements to pay out profits to shareholders within two and one half years places an unwarranted burden on mining companies and should be rejected. The White Paper suggestion to substitute stock dividends to conserve cash is not, in our opinion, a solution. The administrative expense and problems of stock dividends render them impossible to issue as frequently as would be required to solve the problem.

The integration proposals of the White Paper allow 100% of the corporate taxes of a closely held corporation to be passed on to shareholders whereas shareholders of widely held corporations will only be eligible to claim 50% of corporate taxes paid. The reasons given in paragraph 4.35 for limiting the creditable tax available to shareholders of widely held corporations is that U.S. corporations bear tax at 52.8% and United Kingdom corporations pay tax at 45%. As the integration theory is an effort to avoid double taxation on profits earned through corporate investment, we are unable to relate the reasoning of paragraph 4.35 to the integration concept. In our opinion, shareholders of closely held corporations should not have any advantage over shareholders of widely held corporations.

The integration proposals will create administration problems both for the tax payer and the tax assessor because of the necessity of identifying each element of surplus and maintaining records of tax and dividends paid on them. The partnership option available to closely held corporations makes the integration proposals unnecessary for that type of a corporation. The total tax burden on mining companies and their shareholders will be increased by integration.

The integration system has been tried in the United Kingdom and has been repealed. In a report by Price Waterhouse & Co., of London, England, the reason for abandoning the integration concept was "increasing difficulty in applying a tax system which united the personal circumstances and taxable potential of individual shareholders with the basis appropriate to the taxation of company property. Profits earned by companies have long ceased to be regarded as income of their shareholders." Nor does the individual shareholder's personal tax position bear any consideration in corporate management's policy decision-making.

Canada cannot afford to experiment with taxation policies that have proven undesirable and unworkable in other countries. We strongly recommend the abandonment of the integration concept, and the retention of the dividend tax credit system of our present Income Tax Act.

Intercorporate Dividends

Under the present Income Tax Act, intercorporate dividends received by Canadian corporations do not attract tax. The White Paper proposes to tax intercorporate dividends but by extending the integration proposals and providing special rules for intercorporate dividends between widely held corporations, under certain circumstances, intercorporate dividends will not be taxable. Taxation on intercorporate dividends is only avoided when the paying corporation has paid tax at a rate at least equal to that of the receiving corporation. Paragraph 4.58 illustrates a situation where a dividend of $100 attracts $10 additional tax by passing through a parent corporation than it would have attracted if it had been received directly by a shareholder of the paying corporation.

The taxation of intercorporate dividends will virtually eliminate the incentive to the mining industry remaining under the White Paper proposals when the incentives are earned by a subsidiary company. Appendix J illustrates that the income tax burden on profits eligible for incentive legislation will be increased from a minimum of 12% to a maximum of 25% by the fact that the profits are passed through a parent corporation.

As pointed out in previous paragraphs, because of the nature of mineral acquisition and development agreements, mining companies are often required to form new corporations to develop mineral properties so that the seller of the property retains some of the risk of exploration and a share interest if the property is developed. The White Paper appears to consider the formation of subsidiary corporations as some

type of tax evasion, whereas in a mining corporation it is a necessary method of expanding their operations. With the removal of the low rate of corporate tax as proposed by the White Paper, the formation of subsidiary corporations will not reduce overall taxation revenues, and in our opinion, should not increase them.

We believe that it is inequitable that intercorporate dividends attract tax. We recommend that dividends pass between corporations tax free.

Dividends from Tax Free Surplus Created Prior to Implementation Day

Under the present Income Tax Act, capital gains earned by corporations and premiums received on issuance of treasury shares can be passed to shareholders tax free. The White Paper proposes to tax all distributions to shareholders, even though the distribution may be from surplus created prior to implementation of the proposals and through corporate transactions that were not taxable at the time the surplus was created. We are strongly opposed to this retroactive legislation and recommend that dividends pass tax free to shareholders when they are paid out of surplus created by taxfree transactions prior to implementation of the proposals.

Exploration and Development Costs

The Present Income Tax Act disallows the deferrment of exploration and development costs if they are incurred after the mine commences production. This rule favours the larger, well-financed mining companies who can afford to complete their exploration and mine development before bringing the property into production. Smaller companies with limited funds often must use production revenues to complete exploration and development programs. We submit that the criteria for identifying exploration and development expenses should be the nature of the expenditure, not the timing.

The Present Income Tax Act, under certain circumstances, allows exploration and development expenditures incurred by a predecessor company to be claimed by a successor corporation who has acquired and placed into production the properties of the predecessor. The Act also allows parties to a joint exploration project to renounce their exploration and development expenses in favour of another party to the joint venture. As outlined in previous paragraphs, mineral exploration agreements often require that a new corporation be formed to exploit a mineral property. The White Paper does not state whether the sections of the present Income Tax Act outlined above will be retained if the proposals are adopted and we recommend that they be retained. In addition, if the "earned" depletion concept is adopted, it should be eligible for transfer in the same manner as exploration and development costs.

The Present Income Tax Act limits the deduction of exploration and development expenditures to amounts expended in Canada. The mineral industry is international in scope and Canadian corporations should be encouraged to become international if they are to compete with foreign international mining companies. We recommend that all exploration costs, both foreign and domestic, be allowed as deductions in calculating Canadian Income Taxes. This recommendation will correspond with the White Paper proposal to eliminate "nothings" that now exist in the Income Tax Act.

Capital Cost Allowances

The White Paper has invited comment on Capital Cost Allowance provisions.

Under the Present Income Tax Act, mine buildings and equipment are included in Class 10 and are eligible for capital cost allowances at the rate of 30%. This is a preferred rate to recognize the limited life of mineral properties and to assist a mining corporation to recover the substantial investment required to place a property into production. We recommend the retention of this rate for mine assets and suggest that Class 10 be expanded to include townsites, roads, railroads and other capital costs incurred by mining companies in placing a property into production.

The present Income Tax Act disallows capital cost allowances when assets are constructed on properties not owned by the company. Mining corporations are often required to construct roads, docks and even townsites on properties which they do not own. We recommend that these assets be eligible for capital cost allowance. This recommendation corresponds with the intention of the White Paper to eliminate the "nothings" that exist under the present Income Tax system.

Capital Gains Tax

The absence of a capital gains tax has proven to be an important incentive to attract the foreign and domestic investment required to finance the growth of Canadian industry. This is particularly true of the mineral industry where, although the risk of loss is considerably greater than in other industries, the expected rewards are normally greater.

A capital gains tax is inflationary in that it will be a disincentive to saving and investing. We believe that Canada, particularly the Western and Northern regions, must continue to encourage investment to develop industry. We believe that a capital gains tax will restrict the availability of investment capital necessary to sustain growth, and in particular it will limit the growth of the mineral industry.

A capital gains tax has proven to be difficult to administer in other countries where it is now in effect. Many of the contentious areas of the White Paper are caused by the capital gains tax provisions, particularly the attempt to tax the gains on personal assets of individuals and the asset evaluation problems on introduction. Many briefs will be submitted outlining the inequities and administrative problems of the capital gains tax proposals of the White Paper. We are concerned about all of these problems, but the paragraphs that follow are restricted to illustrating the particular effects the capital gains proposals will have on the mineral industry.

The White Paper proposes to tax unrealized capital gains on an accrual basis every five years. In most instances investment in shares in a new mining company will not stabilize within five years because it normally takes a longer period to explore, complete feasibility studies, equip and place a property into production, and establish the market value. Shareholders of mining companies should not be required to sell a portion of their investment to pay tax on an unrealized gain prior to the shares reaching their true market price.

The White Paper proposes to tax at normal individual rates, capital gains from sources other than shares in widely held companies. We submit that capital gains, if they are to be taxed, should be taxed at less than normal rates and, as in the United States, the rates should be further reduced depending on the period of time the investment is held. We have two reasons for suggesting this. Firstly, a portion of any apparent gain will be caused by inflation, and this factor must be considered in establishing taxation rates. Secondly, whenever gains are taxed, they will be "bunched" into certain taxation years, forcing the taxpayer into higher tax brackets, and into paying higher tax rates on all his income in that particular year. This will mean that although the intention is to tax capital gains at normal rates, they will in effect be taxed at substantially higher rates.

Canadian mining companies with international operations frequently are required to transfer temporarily certain of their personnel to their foreign operations. Under the White Paper proposals, these employees would be treated as emigrants and, before leaving Canada, would be forced to pay capital gains tax on all of their property, including personal property, even though the gains may not be realized. Even without a capital gains tax, it is difficult for a mining company to persuade employees to accept temporary duties outside of Canada. This provision may render it impossible. We recommend that provision be made whereby only realized capital gains be taxable when an employee is temporarily transferred out of Canada.

Conversely, Canadian mining companies import consultants from other countries for temporary periods. Often, these consultants are required to stay long enough to make them taxable as Canadian residents. Under the White Paper proposals, on returning to their native country, they will be required to pay capital gains tax on all gains that have accrued on their property, including personal property even

though the property was never in Canada, was not purchased while the individual was resident in Canada, was not realized during that period, and the gain will again be taxable in his native country when it is realized without credit for Canadian taxes paid. At the present time, it is extremely expensive for a mining company to bring in these consultants because of the high individual taxation rates in Canada. The situation described above concerning taxation of capital gains of temporary residents would tend to make it impossible, and relief must be provided or all Canadian industry will suffer.

Depletion Allowances to Non Operators

The White Paper proposes to eliminate the present 25% depletion allowance deductible from mineral royalties and similar payments received by non-operators. Many agreements which provide for these payments were in effect prior to the introduction of the White Paper, and the rates of income were established on the premise that the depletion allowance would apply. We recommend that the depletion allowance continue to apply if the income is received pursuant to an agreement that was in effect prior to November 7th, 1969.

Property Holdings

Paragraph 5.17 of the White Paper proposes to disallow losses on property holdings of a taxpayer if the loss is created by depreciation, interest or taxes. Although this proposal is intended to plug what is considered to be a loophole used by a certain type of taxpayer, the wording of the White Paper does not limit its application, and we believe suitable wording for such a limitation will be difficult.

Mining companies normally are required to provide housing for their employees, and in many instances housing projects are operated at a loss in order to attract employees to remote mining locations. The White Paper proposal would disallow these losses if they were created by depreciation, interest or taxes.

If adopted, this proposal of the White Paper must be limited so that it will apply only to those taxpayers who are incurring property losses solely to reduce taxes, and not to taxpayers, such as mining companies, who are forced to operate housing projects at a loss in order to provide personnel for their operations.

We agree with the White Paper contention that some taxpayers can temporarily reduce their income taxes by claiming depreciation on property holdings. It is difficult to understand how a property loss caused by interest or taxes can be considered a loophole to reduce taxes. We recommend that any disallowance of property losses be limited to those created by depreciation only.

We are concerned that this proposal and the one that would treat each property holding costing $50,000 or more as a separate depreciation class (to prevent the rollover of property holdings without the recapture of depreciation) will substantially reduce the investment capital available for Canadian housing projects.

Taxation of Canadian Foreign Investment

The Canadian mining industry has developed considerable expertise in exploration and mining techniques which give it a competitive edge in discovering and developing mines anywhere in the world. Throughout this submission, we have emphasized the need for the Canadian mineral industry to conduct its operations on a world-wide scale in order to be able to compete in an industry governed by world markets. Revenues from foreign investment increase Canadian foreign exchange reserves.

Under the present Income Tax Act, dividends from controlled foreign corporations are exempt from Canadian tax. The White Paper proposes to remove this exemption except for those countries with which Canada has a tax treaty agreement. This provision will create difficulty in these countries which have little to gain in establishing tax treaties, mainly the developing nations. We believe that Canadian mineral investment in the developing countries should be encouraged, not discouraged.

In our opinion, the treatment of international income under the present Income Tax Act has operated well, has avoided foreign tax credit complications (which the White Paper will introduce), has allowed Canadian corporations to be competitive with foreign corporations, and should be retained.

Foreign Investment in Canada

The White Paper acknowledges that Canada must continue to attract foreign investment in order to sustain the development of the country. This is particularly true of the mineral industry where large amounts of capital are required to finance exploration programs and to place new properties into operation.

The White Paper proposal to tax accrued unrealized capital gains every five years would apply to certain non-residents. The non-resident would be unable to obtain credit in his own country for Canadian taxes paid on unrealized Canadian gains.

We believe that the White Paper proposals to tax capital gains of non-residents will be so difficult to administer, will provide so many loopholes for evasion, will be so inequitable to the foreign investor, and will so substantially discourage foreign investment in Canada, that they should be rejected.

The White Paper proposes to limit the integration concept to Canadian residents and to increase to 25% the present 15% withholding tax on dividends paid to shareholders resident in non-treaty countries. These proposals will also inhibit foreign investment in Canada. We have already stated our objections to the integration concept, and the discriminatory effect it will have on the non-resident shareholder further supports our objections.

Conclusion

We trust that our submission exposes the weaknesses of the White Paper as far as the mining industry is concerned. The history of our company shows that existing tax incentives have created an entity generating large direct and indirect taxation revenues. While we agree that every tax system requires review and revision from time to time we feel that the experience of the Canadian mining industry, which has developed so strongly primarily as a result of tax incentives, should serve as an example for the development of other industries in Canada.

Being intimately involved in the workings of the Canadian mining industry, we are of the opinion that our industry is at a point of great advancement or of stagnation. The growth will continue if Canadians are wise enough to continue to provide economic and political stability and tax incentives. The industry will stagnate if the present state of uncertainty continues both with respect to economic and taxation policies, not to mention the adverse effect if the White Paper Proposals were to be enacted.

APPENDIX A

Editor, The Northern Miner

There is a proposal in the White Paper on taxation now receiving a good deal of discussion in Canada to obliterate the three-year exemption from corporate taxes on new mines coming into production.

When the late McKenzie King formed his government in the autumn of 1935 following the general election a few weeks earlier, he asked me to consolidate what were really four departments of government then with two ministers and four deputy ministers; included in these was the Federal Department of Mines. The necessary legislation bringing this about was passed by Parliament in the Session of 1936 and the new department was given the name of Mines and Resources. I happened to be its first Minister. There was a provision in the Legislation that when the reorganization was completed the Act would be brought into effect by proclamation and this happened in the autumn of 1936.

My knowledge of mining was practically nil. I recall that Mr. Dick Pearce who was then active in The Northern Miner was good enough to come to Ottawa at my request. We had a long talk and I got my first lesson in the mining industry. I also got in touch with the late Noah Timmins, then a leading figure in the mining industry. Another leading figure was Mr. Donald McAskill, then President of International Nickel. What I learned about mining from these gentlemen was a bit of a revelation to me. I recall that I delivered a series of addresses over the radio in which I endeavoured to explain the economic possibilities of the mining industry for Canada. These addresses brought a good deal of favourable comment and were consolidated in a booklet which was given wide distribution to the press, high schools and universities.

As it happened I was a member of the Treasury Board all the time I was in Mr. King's government until I resigned in April, 1945. As I recall now, early in 1937 Donald McAskill called to see me one day when he was in Ottawa. A short time before this visit I had read the last annual report of International Nickel. I remember that the total annual pay-out in the operation of the mine was then over forty million dollars. I asked Donald if he could give me an analysis of the annual amount paid out for all purposes by the mine, broken down into about a score of items. He replied that he thought he could send me this information in a couple of weeks time. In due course I received it and found it extremely interesting. I recall finding, for example, that they purchased every year large quantities of fir timber from British Columbia, considerable quantities of fluxing material from a dried out lake in Saskatchewan; the biggest item, of course, was wages, but there was a considerable item for electrical power and about a dozen towns and cities in the rest of Canada benefited from the purchases the mine made. I was quite surprised to learn the manner in which the operations of International Nickel fertilized the economy of Canada.

At that time the late Charles A. Dunning was Minister of Finance and as Minister of Finance was the Chairman of the Treasury Board which met once a week. I recall that one day in the spring when Mr. Dunning was working on his budget I suggested to him that in his budget he should provide three years' exemption from corporate taxes for new mines coming into production. He demurred strongly at first saying the country could not afford to lose the revenue. I told him I thought he was wrong in that, if anything, it would increase his revenue and not lower it. Laughingly I said to him: "If you don't do it, Charlie, I will take it to the Cabinet and I will beat you on it." And then in a more serious tone I said: "When I go back to my office I am going to send you an analysis of the spending of International Nickel for the last year which I received a few days ago from Mr. McAskill, the President, and ask you not to make a final decision until you have studied it." When I returned to my office I sent him this document. The next day I saw him at lunch at the Rideau Club and he told me quite frankly that he had no idea of how widespread the spending of International Nickel was and he added: "We do not need to take the matter to Council. I will agree now to put this provision in the budget."

That is the origin in some detail of the three-year exemption for new mines coming into production. The impression I early formed that metal mining was one of the best fertilizers of our economy has always remained with me and that is why I believe the new proposal in the White Paper is unfortunate.

One more thing—I think industrial companies and the mining industry in particular have missed and are continuing to miss the opportunity to give the public the facts in their annual reports of how their spending is distributed. We live under a system of government that is called democratic by which is meant that every citizen over twenty-one years of age has an opportunity to have a say in how he is governed. If he is to vote intelligently he needs all the information he can get to make an intelligent decision when an election comes up.

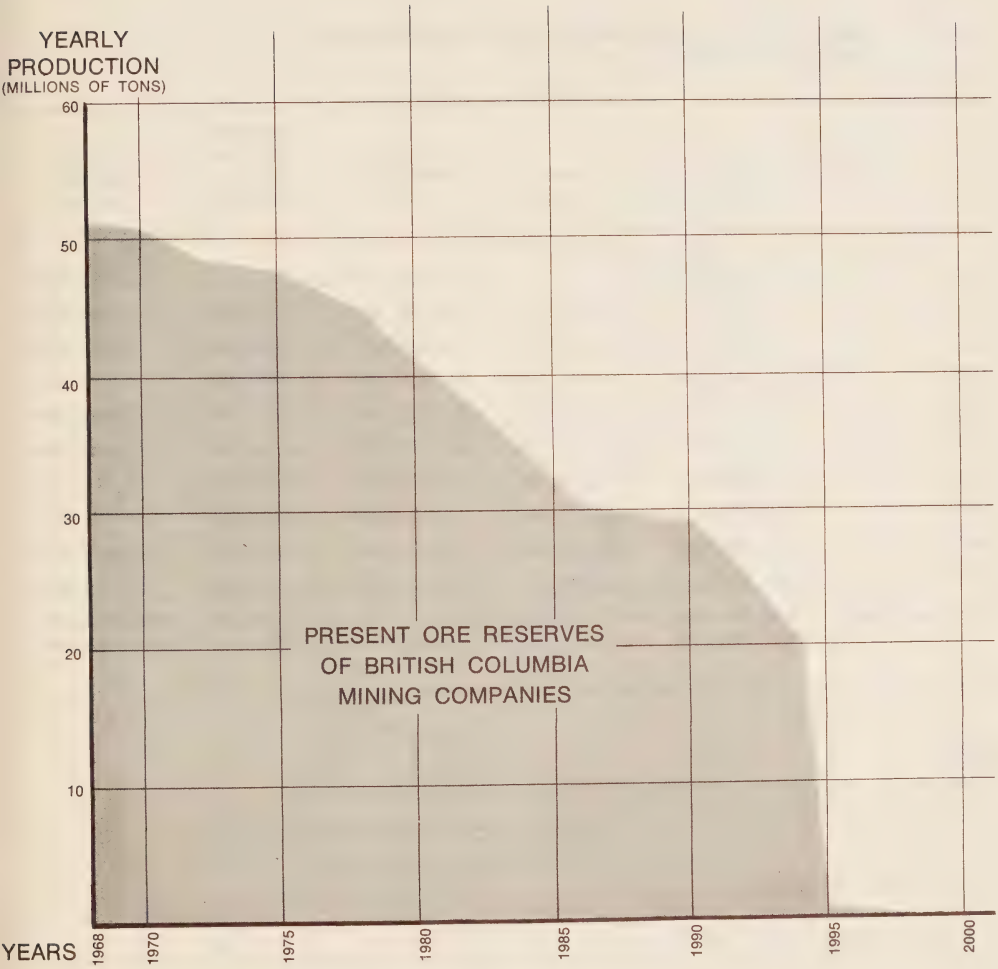
May I suggest that The Northern Miner could do some useful work in this field. I think it probably could get the cooperation of at least a few of the big mines in getting statements from them of how much they pay out each year in wages, materials, etc., analyzed under say a score of headings. If this had been done in the past it would be very useful now when the whole matter is under debate. Even now it would be excellent information to place before the committee of the Commons which will shortly undertake a study of this rather formidable White Paper.

This is a long letter but I thought it might be interesting to you as the Editor of Canada's leading mining journal.

Victoria, B.C. T.A. Crerar

Editor's Note: The Hon. Thomas Crerar, one of the Canadian mining's great and good friends, is now retired. He was first elected to the House of Commons in 1917 and served two years as Minister of Agriculture. From 1936 to 1945 he was Minister of Mines and Resources and then was appointed to the Senate where he served until 1966.

APPENDIX B


YEARLY
PRODUCTION
(MILLIONS OF TONS)
60
50
40
30
20
10
PRESENT ORE RESERVES
OF BRITISH COLUMBIA
MINING COMPANIES
YEARS
1968
1970
1975
1980
1985
1990
1995
2000

APPENDIX C

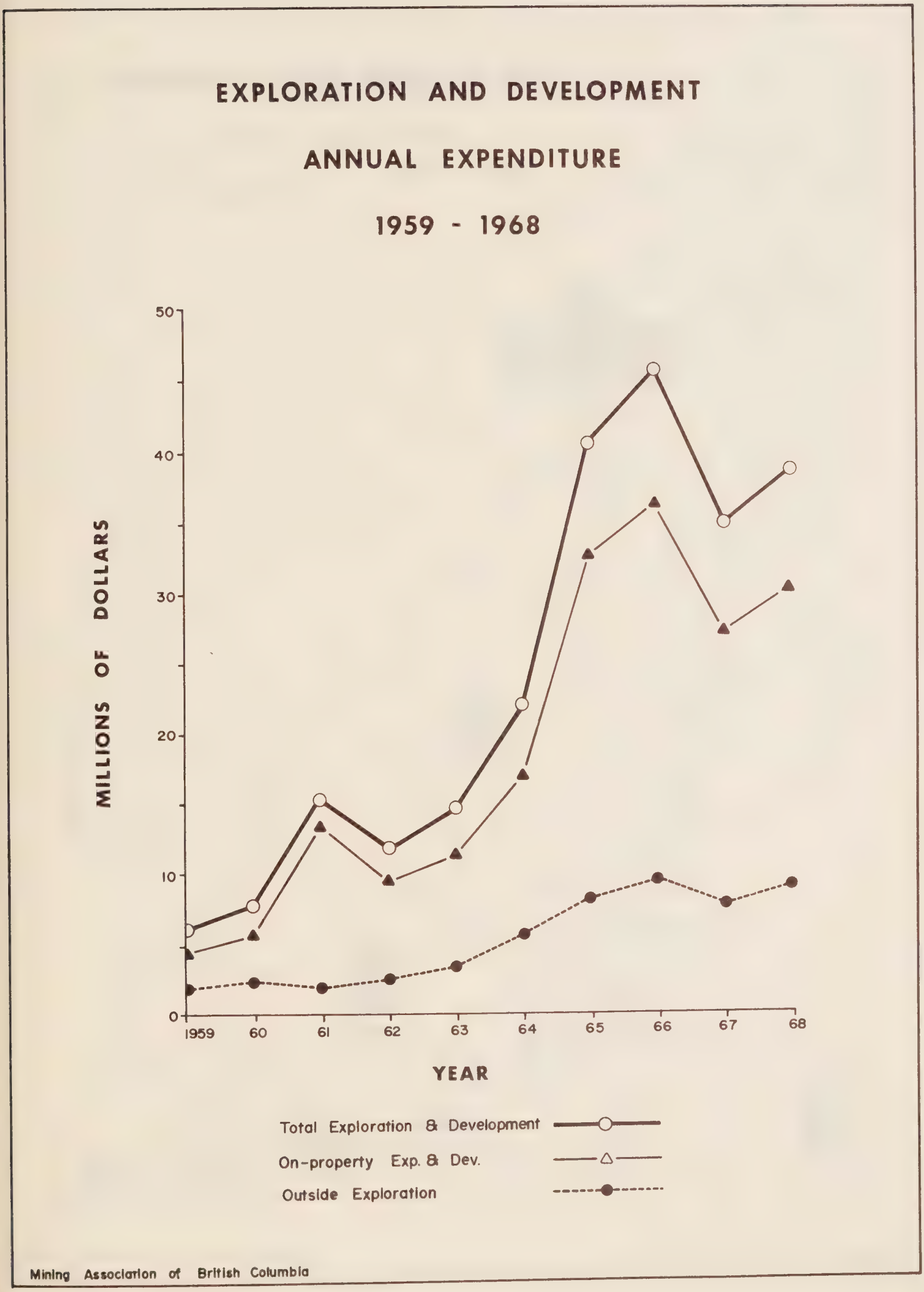
Table 3. SUMMARY OF NET CAPITAL INFLOW TO THE MINING INDUSTRY OF BRITISH COLUMBIA 1959 - 1968

	Equity Capital (Table 4)	Loan Capital	Internally Generated Capital	Repayment of Loan Capital (Deduct)	Net Capital Inflow
1959	$ 2,357,000	$ -	$ 16,029,000	$ -	$ 18,386,000
1960	4,730,000	4,835,000	19,436,000	(815,000)	28,186,000
1961	12,220,000	10,230,000	18,337,000	(185,000)	40,602,000
1962	7,595,000	2,957,000	34,026,000	(4,699,000)	39,879,000
1963	9,765,000	12,294,000	29,855,000	(4,276,000)	47,638,000
1964	31,702,000	14,510,000	40,195,000	(4,024,000)	82,383,000
1965	38,950,000	32,916,000	63,593,000	(7,097,000)	128,362,000
1966	42,576,000	63,370,000	85,935,000	(15,144,000)	176,737,000
1967	27,734,000	46,140,000	91,177,000	(18,574,000)	146,477,000
1968	48,753,000	56,686,000	95,142,000	(20,316,000)	180,265,000
Ten-year Totals	$226,382,000	$243,938,000	$493,725,000	$(75,130,000)	$888,915,000

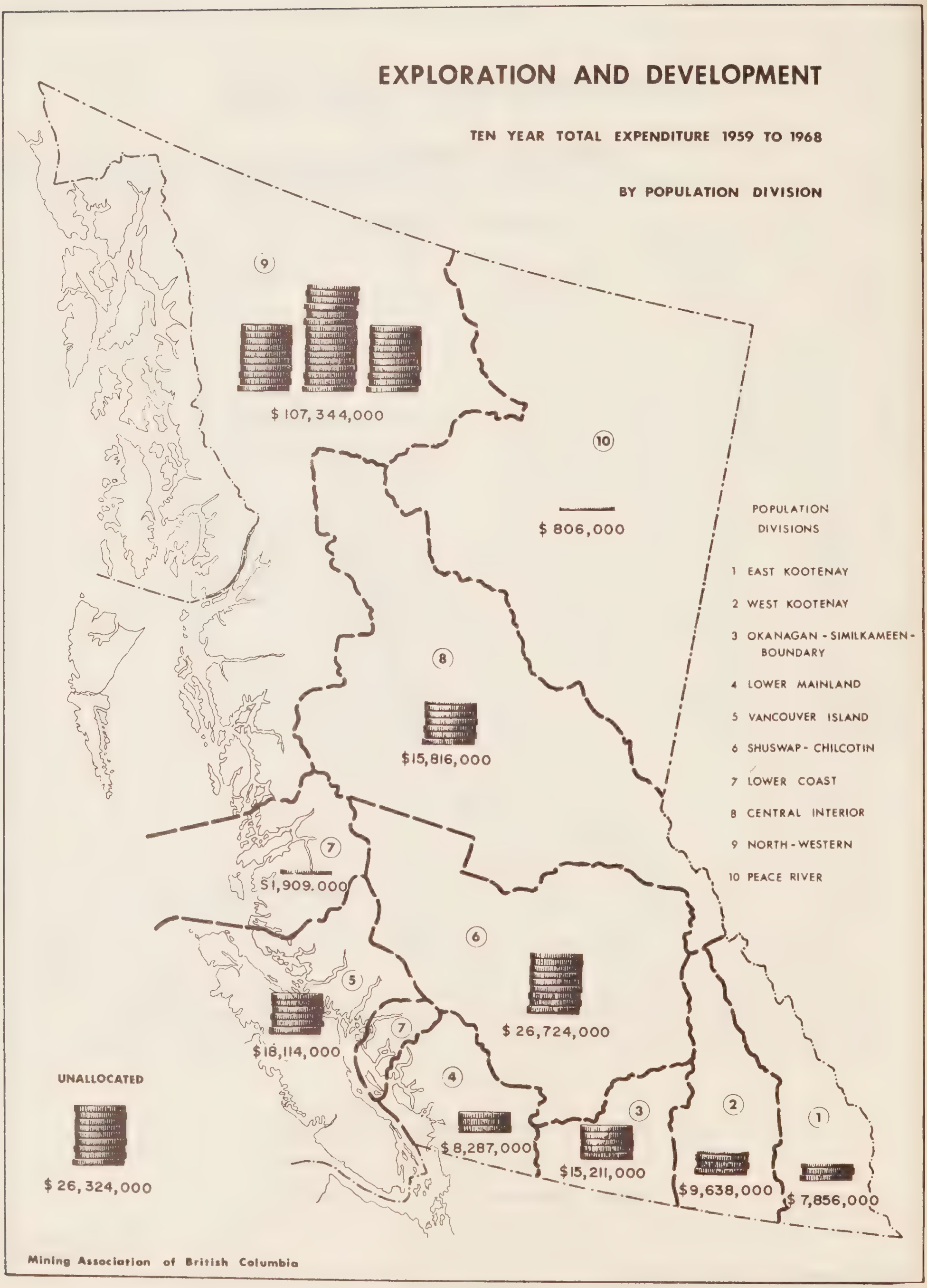
Note:

The equity capital and net capital inflow amounts shown above incorporate $107,000,000 raised by the numerous exploration companies who are not members of the Mining Association of British Columbia.

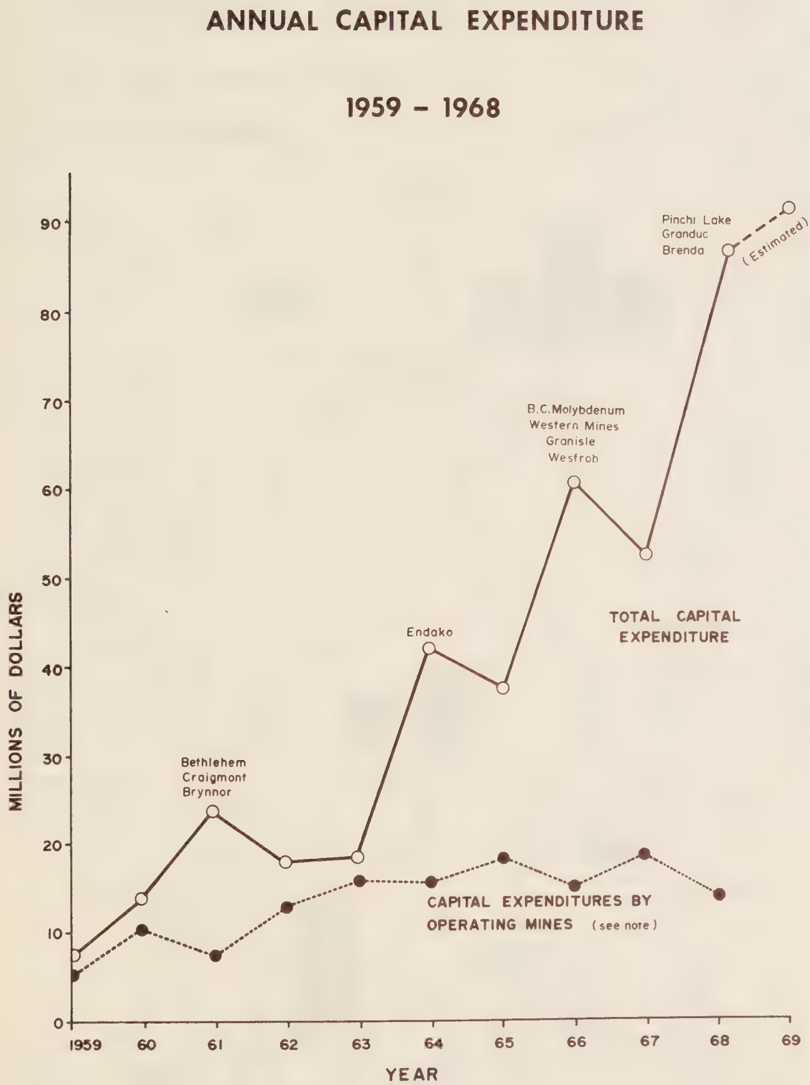
APPENDIX D


EXPLORATION AND DEVELOPMENT
ANNUAL EXPENDITURE
1959 - 1968
MILLIONS OF DOLLARS
0
10
20
30
40
50
1959
60
61
62
63
64
65
66
67
68
YEAR
Total Exploration & Development
On-property Exp. & Dev.
Outside Exploration
Mining Association of British Columbia

APPENDIX E


EXPLORATION AND DEVELOPMENT
TEN YEAR TOTAL EXPENDITURE 1959 TO 1968
BY POPULATION DIVISION
9
$ 107, 344,000
10
$ 806,000
8
$15,816,000
7
$1,909.000
6
$ 26,724,000
5
$18,114,000
7
4
$ 8,287,000
3
$15,211,000
2
$9,638,000
1
$ 7,856,000
UNALLOCATED
$ 26,324,000
POPULATION DIVISIONS
1 EAST KOOTENAY
2 WEST KOOTENAY
3 OKANAGAN - SIMILKAMEEN - BOUNDARY
4 LOWER MAINLAND
5 VANCOUVER ISLAND
6 SHUSWAP - CHILCOTIN
7 LOWER COAST
8 CENTRAL INTERIOR
9 NORTH - WESTERN
10 PEACE RIVER
Mining Association of British Columbia

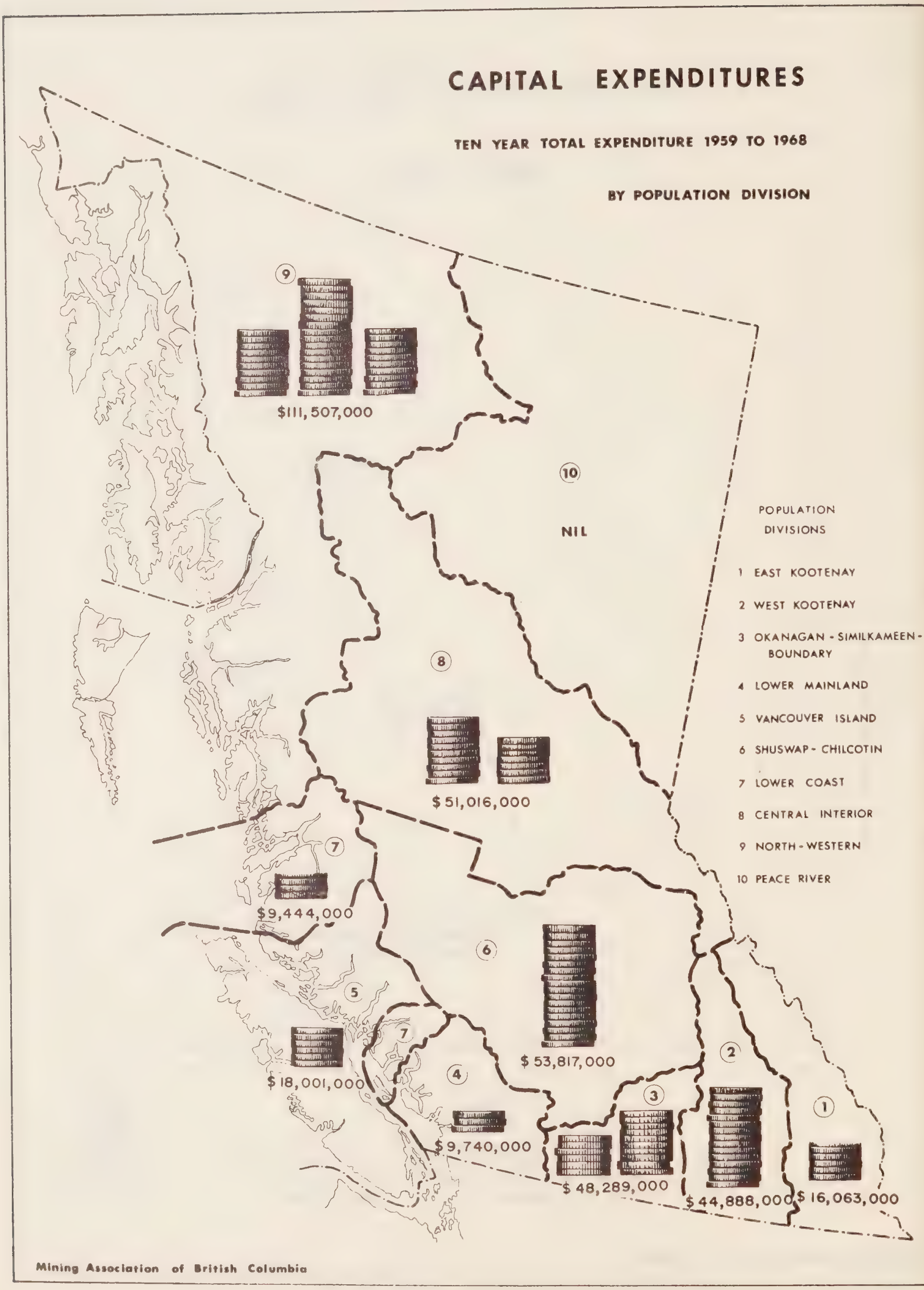
APPENDIX F



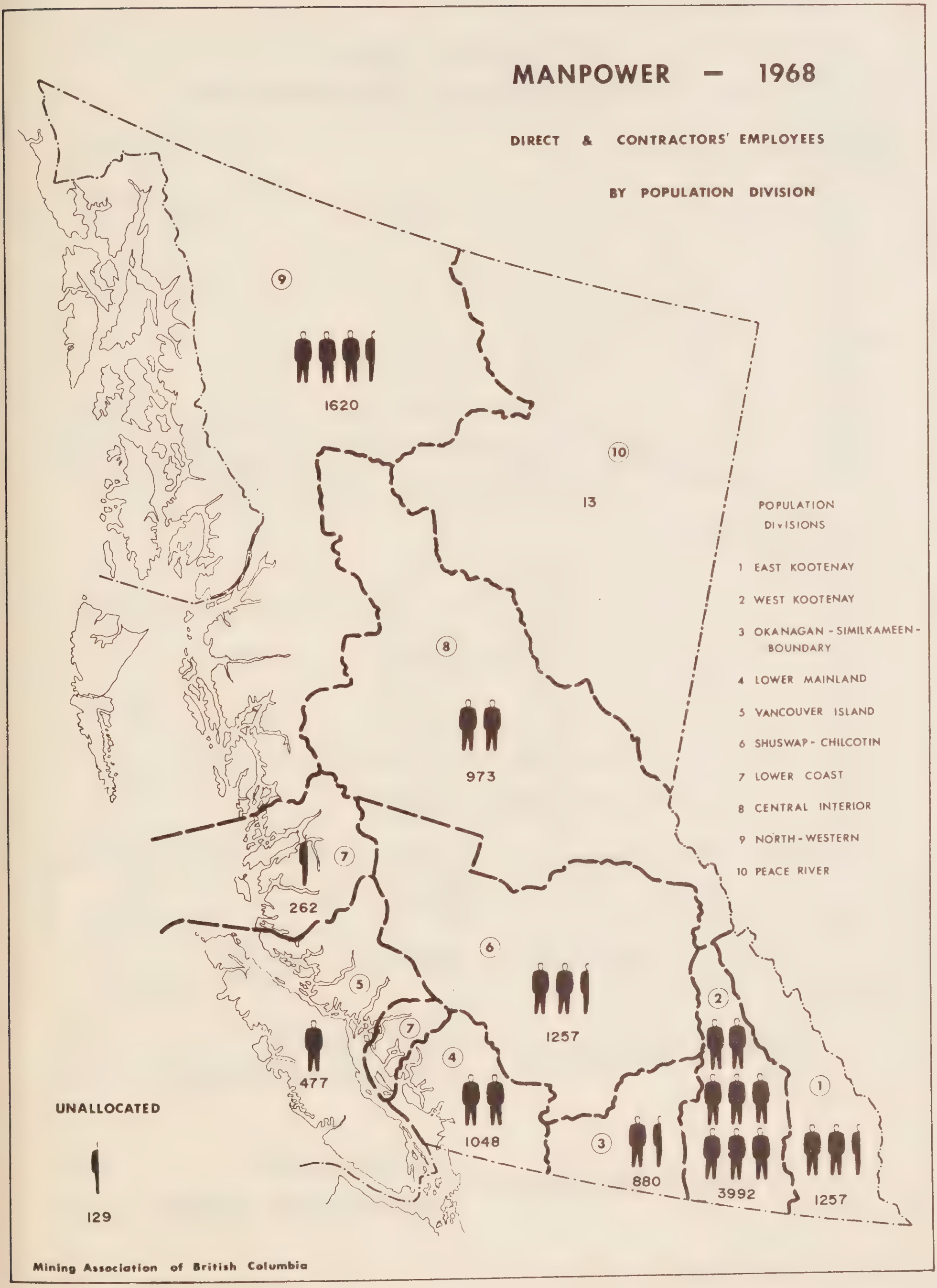
Note Represents regular capital expenditure by operating mines after they have been in operation for one year but excluding such expenditures attributable to expansion of plant facilities

Mining Association of British Columbia

APPENDIX G

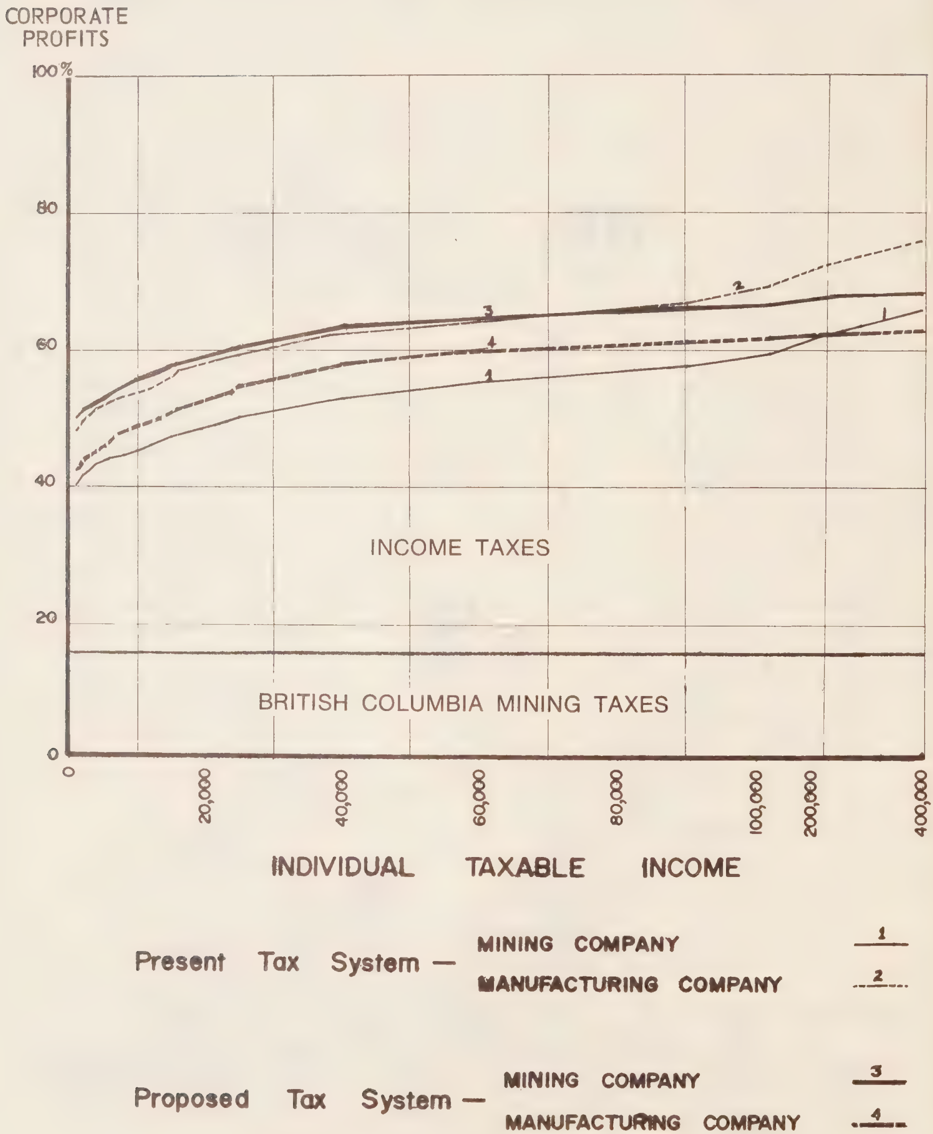

CAPITAL EXPENDITURES
TEN YEAR TOTAL EXPENDITURE 1959 TO 1968
BY POPULATION DIVISION
9
$111,507,000
10
NIL
8
$51,016,000
7
$9,444,000
6
$53,817,000
5
$18,001,000
7
4
$9,740,000
3
$48,289,000
2
$44,888,000
1
$16,063,000
POPULATION DIVISIONS
1 EAST KOOTENAY
2 WEST KOOTENAY
3 OKANAGAN - SIMILKAMEEN - BOUNDARY
4 LOWER MAINLAND
5 VANCOUVER ISLAND
6 SHUSWAP - CHILCOTIN
7 LOWER COAST
8 CENTRAL INTERIOR
9 NORTH - WESTERN
10 PEACE RIVER
Mining Association of British Columbia

APPENDIX H


MANPOWER — 1968
DIRECT & CONTRACTORS' EMPLOYEES
BY POPULATION DIVISION
9
1620
10
13
8
973
7
262
6
1257
5
477
7
4
1048
3
880
2
3992
1
1257
UNALLOCATED
129
POPULATION DIVISIONS
1 EAST KOOTENAY
2 WEST KOOTENAY
3 OKANAGAN - SIMILKAMEEN - BOUNDARY
4 LOWER MAINLAND
5 VANCOUVER ISLAND
6 SHUSWAP - CHILCOTIN
7 LOWER COAST
8 CENTRAL INTERIOR
9 NORTH - WESTERN
10 PEACE RIVER
Mining Association of British Columbia

APPENDIX I

TOTAL TAXATION BURDEN
WIDELY HELD CORPORATIONS AND SHAREHOLDERS



EFFECT OF INTEGRATION ON TAXATION INCENTIVES

TAX FREE PERIOD OR FAST WRITEOFF OF ASSETS

	Closely Held Corporation (Note)		Widely Held Corporation	
	Non Controlled	Wholly Owned Subsidiary of Widely Held Corporation	Non Controlled	Wholly Owned Subsidiary of Widely Held Corporation
Income before Tax Exemption or Fast Writeoff of Assets	200	200	200	200
Tax Exemption or Fast Writeoff				
Say 100%	200	200	200	200
Say 50%				
Income Before Depletion	Nil	Nil	Nil	Nil
Depletion at Maximum Rates				
Taxable Income	Nil	Nil	Nil	Nil
Tax at 50%	Nil	Nil	Nil	Nil
Dividend	200	200	200	200
Gross up by Parent		Nil		Nil
Taxable by Parent		200		200
Parent Corporation Tax				
50%		100		
33-1/3%				67
Tax Credit				
Net Tax to Parent		100		67
Dividend		100		133
Gross up by Shareholder		50		33
Taxable Income of Shareholder	200	150	200	166
Tax at say 50%	100	75	100	83
Tax Credit		50		33
Net Tax to Shareholder	100	25	100	50
Net Dividend to Shareholder	100	75	100	83
Total Tax Paid by original corporation	Nil	Nil	Nil	Nil
Total Tax Paid by parent corporation		100		67
Total Tax Paid by shareholder	100	25	100	50
	100	125	100	117
Increase in Tax due to Taxation of Intercorporate Dividends		25		- 17
Percentage Increase due to Intercorporate Holdings		25%		17%

NOTE: It is assumed that the closely held corporation is not eligible for the partnership election.

APPENDIX J

DEPLETION ALLOWANCE		TAX FREE PERIOD OR FAST WRITEOFF AND DEPLETION	
Widely Held Corporation		Widely Held Corporation	
Non Controlled	Wholly Owned Subsidiary of Widely Held Corporation	Non Controlled	Wholly Owned Subsidiary of Widely Held Corporation
200	200	200	200
		100	100
200	200	100	100
67	67	33	33
133	133	67	67
67	67	33	33
133	133	167	167
	34		16
	167		183
	56		61
	34		16
	22		45
	111		122
34	28	16	30
167	139	183	152
84	70	91	76
34	28	16	30
50	42	75	46
83	69	92	76
67	67	33	33
	22		45
50	42	75	46
117	131	108	124
	14		16
	12%		19%

APPENDIX "H"

NAME: BETHLEHEM COPPER CORPORATION LTD.

SUBJECT: The Impact of the White Paper Proposals on the Canadian Mining Industry

Analysis of Appendix "G" by Senior Advisor

This brief has been filed by the Bethlehem Copper Corporation Ltd. and offers a most comprehensive review of the impact of the White Paper proposals on the Canadian mining industry.

Bethlehem was incorporated in February, 1955 for the purpose of exploring and developing a group of mineral claims in the Highland Valley area of British Columbia. Certain of the mineral claims were placed into production as an open-pit mining operation in December, 1962. The initial mill capacity of 3,300 tons per day has been gradually expanded to its present capacity of approximately 14,500 tons per day.

Since its inception, the financing of Bethlehem proved difficult because of the marginal nature of its properties, and the requirement of the investors to have their capital repaid within a period of time which would not have been possible had it not been for the three year tax exempt period.

The first financing was obtained from American Smelting & Refining Company (Asarco) in the amount of $1,250,000. However, as the results of exploration continued to prove only a marginal property, Asarco was unwilling to finance subsequent developments. The company then solicited the capital markets of Canada and the United States but was unable to raise the funds required to continue its exploration programs.

It was not until the Japanese demand for concentrates began to mount that the company was able to finalize its financing. In 1960 Bethlehem became the first company in Canada to attract substantial Japanese capital to invest in the Canadian mineral industry when the Sumitomo Companies advanced funds to finance an underground exploration program and a mining feasibility study. On the basis of the feasibility study, the Sumitomo Companies advanced to Bethlehem sufficient funds to place the Highland Valley properties into production. Sumitomo's total investment amounted to $5,850,000 (U.S.).

The brief itself:

(1) Reviews the operations of the company and relates to this the importance of tax incentives. (Pages 2, 3 and 4 of Brief)

(2) Offers a comprehensive review for the need of tax incentives for the mining industry. (Pages 5 to 8 of Brief)

(3) Refers to specific White Paper proposals, comprising:

- (a) The Three Year Exempt Period.
- (b) Depletion Allowances.
- (c) Prospectors and Mining Claims.
- (d) Integration of Taxes
  - Depletion on Dividends.
- (e) Integration of Taxes
  - Inter-company Dividends.
- (f) Integration of Taxes
  - Dividends paid out of existing surplus.
- (g) Exploration and Development Costs.
- (h) Capital Cost Allowances.
- (i) The Capital Gains Tax.
- (j) Depletion Allowances to Non-operators.
- (k) Capital Cost Allowances on Certain Properties.
- (l) Taxation of Canadian Foreign Investment.
- (m) Capital Gains Taxes and Withholding Taxes.

The brief also contains very complete charts relating to the mining industry.

The brief concludes with the following statement:

"We trust that our submission exposes the weaknesses of the White Paper as far as the mining industry is concerned. The history of our company shows that existing tax incentives have created an entity generating large direct and indirect taxation revenues. While we agree that every tax system requires review and revision from time to time, we feel that the experience of the Canadian mining industry, which has developed so strongly primarily as a result of tax incentives, should serve as an example for the development of other industries in Canada.

"Being intimately involved in the workings of the Canadian mining industry, we are of the opinion that our industry is at a point of great advancement or of stagnation. The growth will continue if Canadians are wise enough to continue to provide economic and political stability and tax incentives. The industry will stagnate if the present state of uncertainty continues both with respect to economic and taxation policies, not to mention the adverse effect if the White Paper Proposals were to be enacted".

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Three Year Tax Exempt Period

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83, subsection 5 of Income Tax Act This section exempts from tax the income derived from a mine for a period of three years after it commences production in commercial quantities.	1.51 Two main changes are proposed. The first would replace the three-year tax exemption for new mines with a special rule permitting capital costs of fixed assets purchased for the development and operation of a new mine to be charged off against income from that mine as quickly as desired. This change would take effect in 1974 at the expiration of the period for which the government in 1967 gave assurances that the three-year exemption would continue. The new rule would ensure that in the high-risk business of mining, taxes would not be paid until investments in new projects are recovered, but it would do so on a more economical basis than the present exemption.	Pages 9 and 10 of Brief This portion of the brief relates to the three year tax exempt period, and offers the following opinion: We would therefore recommend that the tax exempt concept be retained, but the exempt period would end at the expiration of three years, or when the mining company has earned profits equal to its investment in exploration and development, whichever event occurs first. For purposes of calculating exempt income, investment in capital assets should include investments in townsites, roads, dams, power lines, etc., in addition to mine assets. After expiration of the exempt period, capital assets and exploration expenses would be eligible for normal write-off as is permitted under the present Income Tax Act.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.	

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Depletion Allowances

Present Tax Law

Part XII, Section 1201 of the Income Tax Regulations

This section grants a depletion allowance of 33-1/3% of the net mineral profits remaining after deducting capital cost allowances and 83A credits claimed during the year.

Tax Reform Proposals

1.52 The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Every $3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to $1 of depletion allowances if and when his production profits permit. Depletion allowances on new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system.

Principal Points of Brief

Pages 10 and 11 of Brief

This portion of the brief offers the following opinions:

Equity demands that the effective taxation burden of a mining company cannot exceed that of other Canadian industries (50%). If, as the White Paper states is the intention, an incentive is to be offered, it must result in a taxation burden below that of other Canadian industries and comparable to that paid by the mineral industry in other countries with which Canada competes for investment capital. We believe that these two objectives can be achieved by any of the following methods:

(a) Continuation of the percentage depletion allowances, but with some minor adjustment of rates having regard to depletion allowances in other countries competing with Canada for mining capital. It must be remembered, however, that the percentage must exceed 16% in order to reduce the tax burden below 50%.

(b) Allowing Provincial Mining Taxes to be deducted from Income Taxes plus a smaller percentage depletion allowance. In this circumstance a 16% depletion allowance would result in the 42% effective tax burden now being paid by mining companies. It should be pointed out that the major portion of Provincial Logging Taxes are at the present time deductible from Income Taxes, and the White Paper does not propose any change in this method of treating Logging Taxes.

(c) Allowing Mining Taxes as an offset against Income Taxes or percentage depletion to reduce the effective tax burden to 50% plus "earned" depletion to reduce the burden below that rate. We believe that this is the least favourable of the three recommendations because it relates the incentive to exploration, a concept that we do not accept and it does not offer an incentive comparable to that offered in other countries.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	The White Paper provides a transitional period of 5 years to make the change from a percentage depletion concept to an earned depletion concept. During this period a producing company will be allowed to claim percentage depletion and to build up "earned" depletion credits for application after expiration of the 5 year period. For some unexplained reason, the White Paper has restricted the transition provisions so that they apply only to mineral properties owned prior to the date the White Paper was introduced. As explained in the following section, mineral acquisition agreements often require mineral properties to be transferred to a newly incorporated company when they are brought into production. We believe that this limitation on percentage depletion will restrict the transfer of properties prior to the expiration of the 5 year period, and may in some cases delay production decisions. We cannot understand why property ownership as at November 7th, 1969, should have any bearing on the method of calculating taxable income of mining companies, and we recommend that the percentage depletion be available to all mining companies during the transitional period.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:	

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Prospectors and Mining Claims

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83, subsections 1 to 4 of the Income Tax Act This section exempts from tax the consideration received by a genuine prospector (a) for the sale of mining properties discovered by him, or (b) for the sale of shares of a company received in consideration for the sale of mining properties discovered by him.	5.45 For many years the act has continued a provision which specifically exempts from tax the proceeds received by a prospector or a grub-staker on the sale of a mining property. This provision was intended to make it clear that the government viewed this type of gain as a capital gain which under the existing system would of course be tax-exempt. Under the new proposals capital gains are to be taxed and this exemption would therefore be repealed.	Page 11 and 12 of Brief This portion of the brief states: On November 7th, 1969, the date the White Paper proposals were presented, many prospectors had signed agreements that gave mining companies the option to acquire their properties at some future date. The purchase price of the properties had been established on the premise that the proceeds would be non taxable. If the options are not exercised prior to implementation of the White Paper proposals, at least part of the proceeds will be taxable. We recommend that the proceeds from sale of mineral claims received pursuant to an agreement signed prior to November 7th, 1969, be exempted from taxation. The White Paper proposes to gradually introduce the taxation of mineral properties, taxing 60% of the proceeds in the first year after implementation and increasing the taxable portion by 5% for each subsequent year. The proposals do not provide for the deduction of costs in establishing the taxable portion. We submit that, if the proceeds are to be taxed, the acquisition costs be deducted in calculating the taxable portion of proceeds and that during the transition period, when a percentage of proceeds is taxable, the same percentage of cost be allowed. A major portion of the producing mines in Western and Northern Canada are still discovered through the efforts of individual prospectors. In the past, prospectors have been exempt from taxation on amounts received from sale of mineral properties. The White Paper proposes to eliminate this exemption, but to allow mining companies to deduct the costs of acquiring mineral properties when calculating taxable income. The White Paper fails to recognize the extent of the dependence of the mineral industry on prospectors efforts, and that the motivation for prospecting must always be a promise of substantial reward. It is becoming increasingly difficult in our modern society to find individuals willing to accept the personal sacrifices and risks of failure inherent in prospecting. We recommend that the White Paper proposal to tax the proceeds of sale of mineral properties be rejected.

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Grossing-Up of Canadian Dividends and Depletion on Dividends of Mining Companies

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The provisions of the White Paper relating to the integration of taxes or the grossing-up of Canadian dividend were reviewed in Special Study No. 4 of March 4, 1970 and are not repeated here.		Pages 12 to 14 of Brief This portion of the brief offers the following comments:
Part XIII, Section 1300 of the Income Tax Regulations This section grants a depletion allowance of from 10% to 20% on dividends received from mining companies.	5.44 Also, under the present legislation a depletion alowance of 10 per cent, 15 per cent or 20 per cent may be deducted from dividends received from a mining or oil company, the percentage depending upon the proportion of the income of the corporation which is derived from production. This concession was meant to recognize that the corporation might in fact be paying dividends out of capital. Under the new system this fact would be more accurately recognized by the deduction granted to taxpayers for losses realized on shares which they have held. Therefore it is proposed that shareholders depletion be removed.	The examples used in the illustrations in the above paragraph have ignored the effect of the White Paper Proposals for "earned depletion" and fast write-off of assets of a new mine on the creditable tax available to mining company shareholders. The following table illustrates the effect of earned depletion on taxes a shareholder will pay under the integration proposals.

	Present System	White Paper Proposals
Corporate Income before depletion	9,000	9,000
Depletion at maximum rates	3,000	3,000
Taxable Income	6,000	6,000
Tax at 50%	3,000	3,000
Net Corporate Income	6,000	6,000

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief

	Shareholder Marginal Rate 30%	50%	Shareholder Marginal Rate 30%	50%
Shareholder Dividend	6,000	6,000	6,000	6,000
Less 20% depletion	1,200	1,200	–	–
Add Gross Up	–	–	1,500	1,500
	4,800	4,800	7,500	7,500
Tax at Applicable Rates	1,440	2,400	2,250	3,750
Less dividend tax credit 20%	960	960	–	–
Creditable Tax	–	–	1,500	1,500
Shareholder Tax	480	1,440	750	2,250
Percentage Increase			56%	56%

The preceding two paragraphs show that Canadian investment in the mineral industry will be discouraged by the adoption of the integration concept. As the White Paper proposes to limit the creditable tax concept to Canadian resident shareholders, this increased taxation of the mineral industry will have a lesser effect on the foreign shareholder. There are strong feelings in Canada about Canadian ownership of natural resources, but the White Paper integration proposals appear to encourage foreign ownership.

The White Paper would require that profits of Canadian Corporations be passed to shareholders within two and one half years in order that shareholders may claim the creditable tax. We have indicated in earlier sections of this submission the substantial cost that must be incurred by mining companies in exploring and developing new mineral prospects. In most instances, a substantial portion of these costs must be

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		financed from working capital. We believe that the requirements to pay out profits to shareholders within two and one half years places an unwarranted burden on mining companies and should be rejected. The White Paper suggestion to substitute stock dividends to conserve cash is not, in our opinion, a solution. The administrative expense and problems of stock dividends render them impossible to issue as frequently as would be required to solve the problem. The integration proposals of the White Paper allow 100% of the corporate taxes of a closely held corporation to be passed on to shareholders whereas shareholders of widely held corporations will only be eligible to claim 50% of corporate taxes paid. The reasons given in paragraph 4.35 for limiting the creditable tax available to shareholders of widely held corporations is that U.S. corporations bear tax at 52.8% and United Kingdom corporations pay tax at 45%. As the integration theory is an effort to avoid double taxation on profits earned through corporate investment, we are unable to relate the reasoning of paragraph 4.35 to the integration concept. In our opinion, shareholders of closely held corporations should not have any advantage over shareholders of widely held corporations. The integration proposals will create administration problems both for the tax payer and the tax assessor because of the necessity of identifying each element of surplus and maintaining records of tax and dividends paid on them. The partnership option available to closely held corporations makes the integration proposals unnecessary for that type of a corporation. The total tax burden on mining companies and their shareholders will be increased by integration. The integration system has been tried in the United Kingdom and has been repealed. In a report by Price Waterhouse & Co., of London, England, the reason for abandoning the integration concept was "increasing difficulty in applying a tax system which united the personal circumstances and taxable potential of individual shareholders with the basis appropriate to the taxation of company property. Profits earned by companies have long ceased to be regarded as income of their shareholders." Nor does the individual shareholder's personal tax position bear any consideration in corporate management's policy decision-making. Canada cannot afford to experiment with taxation policies that have proven undesirable and unworkable in other countries. We strongly recommend the abandonment of the integration concept, and the retention of the dividend tax credit system of our present Income Tax Act.

Name: Bethlehem Copper Corporation Ltd.

Date Brief Received:

Principal Subject: Grossing-up of Canadian Dividends and Inter-company Dividends

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 28-1 of the Income Tax Act This section permits dividends to pass from one Canadian company to another free of income tax.	See Special Study No. 4 of March 4, 1970.	Pages 14 and 15 of Brief This portion of the brief offers the following comments: The taxation of intercorporate dividends will virtually eliminate the incentive to the mining industry remaining under the White Paper proposals when the incentives are earned by a subsidiary company. Appendix J illustrates that the income tax burden on profits eligible for incentive legislation will be increased from a minimum of 12% to a maximum of 25% by the fact that the profits are passed through a parent corporation. As pointed out in previous paragraphs, because of the nature of mineral acquisition and development agreements, mining companies are often required to form new corporations to develop mineral properties so that the seller of the property retains some of the risk of exploration and a share interest if the property is developed. The White Paper appears to consider the formation of subsidiary corporations as some type of tax evasion, whereas in a mining corporation it is a necessary method of expanding their operations. With the removal of the low rate of corporate tax as proposed by the White Paper, the formation of subsidiary corporations will not reduce overall taxation revenues, and in our opinion, should not increase them. We believe that it is inequitable that intercorporate dividends attract tax. We recommend that dividends pass between corporations tax free.

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Grossing-up of Canadian Dividends and Dividends paid from Existing Capital Surplus

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 28-1 of the Income Tax Act This section permits dividends to pass from one Canadian company to another free of income tax.	See Special Study No. 4 of March 4, 1970	Page 15 of Brief This portion of the brief states: Under the present Income Tax Act, capital gains earned by corporations and premiums received on issuance of treasury shares can be passed to shareholders tax free. The White Paper proposes to tax all distributions to shareholders, even though the distribution may be from surplus created prior to implementation of the proposals and through corporate transactions that were not taxable at the time the surplus was created We are strongly opposed to this retroactive legislation and recommend that dividends pass tax free to shareholders when they are paid out of surplus created by taxfree transactions prior to implementation of the proposals.

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Exploration and Development Costs

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83A of the Income Tax Act This section restricts to deduction from income allowed for exploration and development costs to expenditures in Canada.	The White Paper makes no specific reference to this subject.	Page 15 of Brief This portion of the brief states: The Present Income Tax Act, under certain circumstances, allows exploration and development expenditures incurred by a predecessor company to be claimed by a successor corporation who has acquired and placed into production the properties of the predecessor. The Act also allows parties to a joint exploration project to renounce their exploration and development expenses in favour of another party to the joint venture. As outlined in previous paragraphs, mineral exploration agreements often require that a new corporation be formed to exploit a mineral property. The White Paper does not state whether the sections of the present Income Tax Act outlined above will be retained if the proposals are adopted and we recommend that they be retained. In addition, if the "earned" depletion concept is adopted, it should be eligible for transfer in the same manner as exploration and development costs. The Present Income Tax Act limits the deduction of exploration and development expenditures to amounts expended in Canada. The mineral industry is international in scope and Canadian corporations should be encouraged to become international if they are to compete with foreign international mining companies. We recommend that all exploration costs, both foreign and domestic, be allowed as deductions in calculating Canadian Income Taxes. This recommendation will correspond with the White Paper proposal to eliminate "nothings" that now exist in the Income Tax Act.

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Capital Cost Allowances

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Part XI of the Income Tax Regulations These regulations permit the deduction from income of capital cost allowances computed on a declining balance basis.	5.14 The system has without doubt proven easy to comply with, and has caused far fewer difficulties between taxpayer and taxgatherer than the more usual "straight-line" system that preceded it in 1948 and earlier years. One of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side. This generosity has acted as an incentive to taxpayers to modernize and improve their business facilities, but naturally at some cost in government revenue. The royal commission did not recommend reductions in depreciation rates. Perhaps for that reason, the rates were not generally an issue in the public debate on tax reform that has taken place over the past two years. Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered. Therefore, the government intends in due course to invite briefs on the system and rates of capital cost allowance.	Pages 15 and 16 of Brief This portion of the brief suggests: Under the Present Income Tax Act, mine buildings and equipment are included in Class 10 and are eligible for capital cost allowances at the rate of 30%. This is a preferred rate to recognize the limited life of mineral properties and to assist a mining corporation to recover the substantial investment required to place a property into production. We recommend the retention of this rate for mine assets and suggest that Class 10 be expanded to include townsites, roads, railroads and other capital costs incurred by mining companies in placing a property into production. The present Income Tax Act disallows capital cost allowances when assets are constructed on properties not owned by the company. Mining corporations are often required to construct roads, docks and even townsites on properties which they do not own. We recommend that these assets be eligible for capital cost allowance. This recommendation corresponds with the intention of the White Paper to eliminate the "nothings" that exist under the present Income Tax system.

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: The Capital Gains Tax

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not levy a tax on capital gains.	The proposals of the White Paper relating to the taxation of capital gains were reviewed in Appendix B, page 8:29 of February 11, 1970.	Pages 16 and 17 of Brief This portion of the brief states: The absence of a capital gains tax has proven to be an important incentive to attract the foreign and domestic investment required to finance the growth of Canadian industry. This is particularly true of the mineral industry where, although the risk of loss is considerably greater than in other industries, the expected rewards are normally greater. A capital gains tax is inflationary in that it will be a disincentive to saving and investing. We believe that Canada, particularly the Western and Northern regions, must continue to encourage investment to develop industry. We believe that a capital gains tax will restrict the availability of investment capital necessary to sustain growth, and in particular it will limit the growth of the mineral industry. A capital gains tax has proven to be difficult to administer in other countries where it is now in effect. Many of the contentious areas of the White Paper are caused by the capital gains tax provisions, particularly the attempt to tax the gains on personal assets of individuals and the asset evaluation problems on introduction. Many briefs will be submitted outlining the inequities and administrative problems of the capital gains tax proposals of the White Paper. We are concerned about all of these problems, but the paragraphs that follow are restricted to illustrating the particular effects the capital gains proposals will have on the mineral industry. The White Paper proposes to tax unrealized capital gains on an accrual basis every five years. In most instances investment in shares in a new mining company will not stabilize within five years because it normally takes a longer period to explore, complete feasibility studies, equip and place a property into production, and establish the market value. Shareholders of mining companies should not be required to sell a portion of their investment to pay tax on an unrealized gain prior to the shares reaching their true market price.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		The white Paper proposes to tax at normal individual rates, capital gains from sources other than shares in widely held companies. We submit that capital gains, if they are to be taxed, should be taxed at less than normal rates and, as in the United States, the rates should be further reduced depending on the period of time the investment is held. We have two reasons for suggesting this. Firstly, a portion of any apparent gain will be caused by inflation, and this factor must be considered in establishing taxation rates. Secondly, whenever gains are taxed, they will be "bunched" into certain taxation years, forcing the taxpayer into higher tax brackets, and into paying higher tax rates on all his income in that particular year. This will mean that although the intention is to tax capital gains at normal rates, they will in effect be taxed at substantially higher rates. Canadian mining companies with international operations frequently are required to transfer temporarily certain of their personnel to their foreign operations. Under the White Paper proposals, these employees would be treated as emigrants and, before leaving Canada, would be forced to pay capital gains tax on all of their property, including personal property, even though the gains may not be realized. Even without a capital gains tax, it is difficult for a mining company to persuade employees to accept temporary duties outside of Canada. This provision may render it impossible. We recommend that provision be made whereby only realized capital gains be taxable when an employee is temporarily transferred out of Canada. Conversely, Canadian mining companies import consultants from other countries for temporary periods. Often, these consultants are required to stay long enough to make them taxable as Canadian residents. Under the White Paper proposals, on returning to their native country, they will be required to pay capital gains tax on all gains that have accrued on their property, including personal property even though the property was never in Canada, was not purchased while the individual was resident in Canada, was not realized during that period, and the gain will again be taxable in his native country when it is realized without credit for Canadian taxes paid. At the present time, it is extremely expensive for a mining company to bring in these consultants because of the high individual taxation rates in Canada. The situation described above concerning taxation of capital gains of temporary residents would tend to make it impossible, and relief must be provided or all Canadian industry will suffer.

Name: Bethlehem Copper Corporation Ltd.

Date Brief Received:

Principal Subject: Depletion Allowances to Non-operators

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Part XII, Section 1202 of the Income Tax Regulations This section grants a depletion allowance of 25% on gross royalties or production interests received by a non-operator of a mine or well.	5.43 Under the present legislation a depletion allowance of 25 per cent may be deducted by non-operators from their income from mineral properties. This provision applies principally to the holders of royalties. The concession sought to recognize that royalties might well in part be a return of capital. This fact would under the present proposals be more accurately recognized by the proposed rules concerning the amortization of the cost of acquiring mineral rights. Therefore it is proposed that the percentage depletion at present available to non-operators be repealed.	Page 17 of Brief This portion of the brief states: The White Paper proposes to eliminate the present 25% depletion allowance deductible from mineral royalties and similar payments received by non-operators. Many agreements which provide for these payments were in effect prior to the introduction of the White Paper, and the rates of income were established on the premise that the depletion allowance would apply. We recommend that the depletion allowance continue to apply if the income is received pursuant to an agreement that was in effect prior to November 7th, 1969.

Name: Bethlehem Copper Corporation Ltd.

Date Brief Received:

Principal Subject: Capital Cost Allowances on Certain Properties

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not impose any special limitation on capital cost allowances that can be claimed in respect of buildings.	5.16 Many taxpayers who would otherwise be in quite high tax brackets have become landlords, and have been able to reduce or eliminate the tax on their other income by claiming the maximum depreciation on their buildings. Ideally this early generosity should be offset by lower depreciation deductions in later years, or by recapture of the extra depreciation on sale. However, if the taxpayer buys additional buildings—and with the relatively low down payments required, this can often be done out of the tax savings alone—he can postpone almost indefinitely the day when his total depreciation deductions will drop below average. Moreover, since most of the buildings concerned are in the same class, a taxpayer who sells a building can avoid recapture of the proceeds by investing them in another building. Finally, if the taxpayer continues this process throughout his life, the tax postponed becomes tax saved forever. When a taxpayer dies, excess depreciation is not recaptured, and the person who inherits the buildings is entitled to depreciate the full fair market value of the buildings, no matter what net book value his predecessor had.	Page 17 of Brief This portion of the brief states: Mining companies normally are required to provide housing for their employees, and in many instances housing projects are operated at a loss in order to attract employees to remote mining locations. The White Paper proposal would disallow these losses if they were created by depreciation, interest or taxes. If adopted, this proposal of the White Paper must be limited so that it will apply only to those taxpayers who are incurring property losses solely to reduce taxes, and not to taxpayers, such as mining companies, who are forced to operate housing projects at a loss in order to provide personnel for their operations. We agree with the White Paper contention that some taxpayers can temporarily reduce their income taxes by claiming depreciation on property holdings. It is difficult to understand how a property loss caused by interest or taxes can be considered a loophole to reduce taxes. We recommend that any disallowance of property losses be limited to those created by depreciation only. We are concerned that this proposal and the one that would treat each property holding costing $50,000 or more as a separate depreciation class (to prevent the rollover of property holdings without the recapture of depreciation) will substantially reduce the investment capital available for Canadian housing projects.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Taxation of Canadian Foreign Investment

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 28-1 of the Income Tax Act This section permits a Canadian company to receive dividends free of tax from a foreign company, as long as the Canadian owns 25% or more of the voting capita stock of the foreign company.	4.46 The government does not propose-to give individuals who hold shares in foreign corporations credit for the corporate tax paid by those corporations. For the most part, the investment that a Canadian can make in a foreign corporation will be in a public corporation or in a corporation large enough to compete with public corporations. Therefore the pricing and profit structure of the corporation will contemplate the payment of a corporation tax. And of course the government has no desire to provide an incentive to Canadians to invest in foreign corporations: it does not intend to put barriers in the way of their doing so but it does not want to provide a tax incentive to induce them to do so. Further, most foreign countries have a corporation tax which is separate from the personal income tax and do not give a credit to shareholders in respect of the corporation tax paid by the corporation. If Canada were to give a credit for the corporation tax paid in that country, it would be giving Canadians an advantage over the residents of the country in the business enterprises of that country. Finally, it is one thing to forgo taxes to accomplish a given purpose. This is what is being done with respect to Canadian shareholders of Canadian corporations. It is a quite different thing to make payments to people in respect of taxes paid to other countries: this would represent a net drain on the Canadian treasury.	Pages 17 and 18 of Brief This portion of the brief states: The Canadian mining industry has developed considerable expertise in exploration and mining techniques which give it a competitive edge in discovering and developing mines anywhere in the world. Throughout this submission, we have emphasized the need for the Canadian mineral industry to conduct its operations on a world-wide scale in order to be able to compete in an industry governed by world markets. Revenues from foreign investment increase Canadian foreign exchange reserves. Under the present Income Tax Act, dividends from controlled foreign corporations are exempt from Canadian tax. The White Paper proposes to remove this exemption except for those countries with which Canada has a tax treaty agreement. This provision will create difficulty in these countries which have little to gain in establishing tax treaties, mainly the developing nations. We believe that Canadian mineral investment in the developing countries should be encouraged, not discouraged. In our opinion, the treatment of international income under the present Income Tax Act has operated well, has avoided foreign tax credit complications (which the White Paper will introduce), has allowed Canadian corporations to be competitive with foreign corporations, and should be retained.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	4.48 The government does propose, however, to grant to Canadian corporations which have a controlling interest in foreign corporations, credit for the corporation taxes paid by those foreign corporations. These Canadian corporations stand in the same relationship to their foreign controlled corporations as does the Canadian individual shareholder to the closely-held Canadian corporation in which he has an interest. Again, this proposal is outlined in greater detail in Chapter 6.	
	6.20 As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely.	

Name:

Date Brief Received:

Principal Subject:

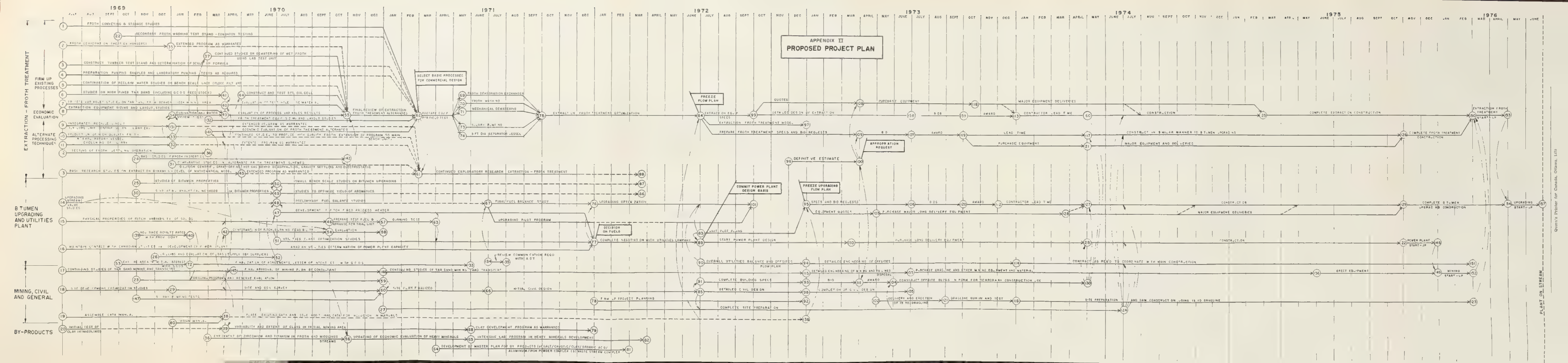
Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.	

Name: BETHLEHEM COPPER CORPORATION LTD.

Date Brief Received:

Principal Subject: Foreign Investment in Canada
– Capital Gains Tax and Withholding Taxes

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not impose a tax on capital gains. Section 106-1a of the Income Tax Act This section requires that a Canadian tax of from 10% to 15% be withheld from dividends paid to non-residents of Canada by a corporation resident in Canada.	The White Paper proposes that unrealized gains arising from the five year revaluation be included in income. It also proposes that the Canadian withholding tax be increased from 15% to 25%.	Page 18 of Brief This portion of the brief states: The White Paper acknowledges that Canada must continue to attract foreign investment in order to sustain the development of the country. This is particularly true of the mineral industry where large amounts of capital are required to finance exploration programs and to place new properties into operation. The White Paper proposal to tax accrued unrealized capital gains every five years would apply to certain non-residents. The non-resident would be unable to obtain credit in his own country for Canadian taxes paid on unrealized Canadian gains. We believe that the White Paper proposals to tax capital gains of non-residents will be so difficult to administer, will provide so many loopholes for evasion, will be so inequitable to the foreign investor, and will so substantially discourage foreign investment in Canada, that they should be rejected. The White Paper proposes to limit the integration concept to Canadian residents and to increase to 25% the present 15% withholding tax on dividends paid to shareholders resident in non-treaty countries. These proposals will also inhibit foreign investment in Canada. We have already stated our objections to the integration concept, and the discriminatory effect it will have on the non-resident shareholder further supports our objections.


APPENDIX II
PROPOSED PROJECT PLAN
1969
1970
1971
1972
1973
1974
1975
1976
EXTRACTION - FROTH TREATMENT
FIRM UP EXISTING PROCESSES
ECONOMIC EVALUATION
ALTERNATE PROCESSING TECHNIQUES
BITUMEN UPGRADING AND UTILITIES PLANT
MINING, CIVIL AND GENERAL
BY-PRODUCTS
SELECT BASIC PROCESSES FOR COMMERCIAL DESIGN
FREEZE FLOW PLAN
COMMIT POWER PLANT DESIGN BASIS
FREEZE UPGRADING FLOW PLAN
APPROPRIATION REQUEST
DEFINITIVE ESTIMATE
DECISION ON FUELS
PLANT ON STREAM

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable DOUGLAS D. EVERETT,
The Honourable LAZARUS PHILLIPS, *Acting Chairmen*

No. 20

THURSDAY, APRIL 30th, 1970

Fourteenth Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 20:5)

APPENDICES:

"A"—Brief from the Canadian Association of Real Estate Boards.
"B"—Brief from the Canadian Construction Association.
"C"—Brief from Markborough Properties Limited.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from Budd Automotive Company of Canada Limited.
"F"—Analysis of Appendix "E" by Senior Advisor.
"G"—Brief from Conwest Exploration Company Limited.
"H"—Analysis of Appendix "H" by Senior Advisor.

21887—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(29)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

21887—1½

MINUTES OF PROCEEDINGS

THURSDAY, April 30th, 1970.
(28)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Everett (*Acting Chairman*), Aseltine, Beaubien, Blois, Burchill, Connolly (*Ottawa West*), Cook, Molson, Phillips (*Rigaud*) and White—(10).

Present, but not of the Committee: The Honourable Senators Laird and Smith—(2).

Upon motion the Honourable Senator Everett was elected as *Acting Chairman.*

In attendance: Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Canadian Association of Real Estate Boards

Mr. F. N. McFarlane, President;
Mr. J. T. B. Jackson, Director of Research & Public Relations;
Col. J. A. Hutchins, General Counsel & Director of Information; (Montreal Real Estate Board);
Mr. B. R. B. Magee, Past President, (Toronto Real Estate Board);
Mr. R. J. Dart, Consultant;
Mr. P. Vineberg, Q.C., Counsel and Chief Spokesman.

Upon arriving, the Honourable Senator Phillips (*Rigaud*) assumed the Chair as *Acting Chairman.*

Canadian Construction Assn.

Mr. R. G. Saunders, P.Eng., President;
Mr. M. Stein, Eng., Immediate Past-President;
Mr. R. MacTavish, C.A., Chairman, Taxation Committee;
Mr. R. A. Bird, P.Eng., Member, Taxation Committee;
Mr. S. D. C. Chutter, General Manager, Ottawa;
Mr. K. V. Sandford, Taxation Officer, Ottawa.

Markborough Properties Ltd.

Mr. B. R. Magee, President;
Mr. R. D. Brown, Price, Waterhouse & Co.;
Mr. D. F. Prowse, Vice President, Finance.

At 12:30 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(29)

At 2:15 p.m. the Committee *resumed.*

Present: The Honourable Senators Phillips (*Acting Chairman*), Aseltine, Beaubien, Burchill, Connolly (*Ottawa West*), Cook, Desruisseaux, Everett, Gelinas and Molson—(10).

Present, but not of the Committee: The Honourable Senator Laird—(1).

Upon motion the Honourable Senator Phillips was elected as *Acting Chairman.*

In attendance: Alan J. Irving, Legal Advisor.
The following witnesses were heard:

Budd Automotive Company of Canada Ltd.

Mr. L. G. Dawson, Vice-President—Finance;
Mr. A. W. Black, Plant Controller;
Mr. D. J. Michael, Financial Services Manager.

Conwest Exploration Co. Ltd.

Mr. C. R. Elliott, President;
Mr. M. P. Connell, Treasurer;
Mr. J. C. Lamacraft, Chartered Accountant.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from the Canadian Association of Real Estate Boards.
B—Brief from the Canadian Construction Association.
C—Brief from Markborough Properties Limited.
D—Analysis of Appendix "C" by Senior Advisor.
E—Brief from Budd Automotive Company of Canada Limited.
F—Analysis of Appendix "E" by Senior Advisor.
G—Brief from Conwest Exploration Company Limited.
H—Analysis of Appendix "H" by Senior Advisor.

NOTE: Appendices "A" and "B" arrived too late for the usual analysis by the Senior Advisor.

At 3:50 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, April 30, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

The Clerk of the Committee: Honourable senators, due to the unavoidable absence of the chairman, is it your pleasure to elect an acting chairman?

Senator Molson: I move that Senator Everett be acting chairman.

The Clerk of the Committee: Is it agreed that Senator Everett be elected acting chairman?

Hon. Senators: Agreed.

Senator Douglas D. Everett (*Acting Chairman*) in the Chair.

The Acting Chairman: Honourable senators, Senator Phillips (Rigaud) will be here later in the morning. With your permission I should like to change the order of appearances as they appear on the list, and to call first the Canadian Association of Real Estate Boards. Is it agreed?

Hon. Senators: Agreed.

The Acting Chairman: I will ask Mr. McFarlane to come forward and introduce the members of his group.

Mr. F. N. McFarlane (President, Canadian Association of Real Estate Boards): Thank you, Mr. Chairman and honourable senators. I think I might be forgiven, Mr. Chairman, for remarking that this morning is less cloudy than yesterday in the light of last night's events. It would have been difficult to have predicted a sunnier, happier day for Canada than this morning.

On my far right is Mr. Robert J. Dart who is a partner in the firm of Price Waterhouse of Toronto and a gentleman who has acted as our consultant. On his left is Mr. J. T. B. Jackson of Toronto, Research Director of the Canadian Association of Real Estate Boards. Next to him is Colonel J. A. Hutchins of Montreal, General Counsel and Director of Information for the Montreal Real Estate Boards; Brian Magee, Chairman of the Board of A. E. LePage Limited, and Vice President of the Toronto Real Estate Board; and then Mr. Phillip Vineberg, Q.C., of Montreal, who has acted as our counsel and who will be our chief spokesman.

Mr. Chairman, before handing over to Mr. Vineberg it would be appropriate perhaps if I made reference to our association. It comprises some 85 local real estate boards, 10 provincial associations, and some 25,500 members. We have in our membership numerous large firms, but by far the vast majority of the membership is made up of small businessmen.

I should mention also that we have as affiliated members representatives of the Federal Department of Public Works, Central Mortgage and Housing Corporation, the R.C.M.P., et cetera. It would be fair to say that those people are affiliated with our association in order to take advantage of some of our educational programs and to receive the statistical information which we have available.

Our association is devoted to finding housing for the Canadian people and Canadian business, and it is fair to say that never have we been regarded as a pressure group seeking special concessions for our membership. On the contrary, we have tried always to conduct ourselves on a higher level than that. As for our submission, we have endeavoured to confine its position to those areas in which we might be considered to have particular expertise.

With those few remarks, Mr. Chairman and honourable senators, if it is your wish I will hand over to our chief spokesman, Mr. Vineberg.

Mr. P. Vineberg, Counsel, Canadian Association of Real Estate Boards: Mr. Chairman and

honourable senators: this morning as a Quebecker I am very happy and proud to say fellow Canadians. As Mr. McFarlane has just pointed out, it is our intention to make submissions particularly with respect to housing and real estate, those matters which come within our special purview and in respect of which we consider that we have some particular experience with our 25,000 members. We are not going to deal with general economic or fiscal aspects of the White Paper. However, there are a few preliminary points that might be made before we introduce the question of housing. First of all, there is an element of tax increase. Like many others, we feel that tax increase has nothing to do with tax reform, but is a separate and distinct subject. Moreover, the proponents of the White Paper and its authors have indicated that it was not their intention to introduce any increase. There was to be, roughly speaking, the same amount of taxation at the end of the reformation as there had been at the beginning. Obviously the level of taxation is a parliamentary enactment and not the purpose of a White Paper.

We have a capital gains tax system which will take some time before the bite is operative. As a result they start with the same amount of money and as the bite of the capital gains tax becomes more effective it yields an additional amount, measured in terms of 1969 dollars drawn at 1970 figures and GNP, at something over $600 million. The Ontario government, using essentially the same figures drawn from the Department of National Revenue, has computed the figure at roughly twice that amount, $1,200 million.

We have no special knowledge in that sphere. We suspect it is a good deal more than $600 million. That does not take into account any growth in the GNP, inflationary tendencies, growth in population, and various factors that in time would lead to an increase. We do start off with a White Paper that has in it an increase in excess of $600 million and perhaps $1,200 million, most of which is centred around the capital gains tax. It is appropriate to consider whether in the analysis of those measures you will hear about from us and others there is some room for adjustment. We submit that there is built into the White Paper an area of adjustment which in itself recognizes this as $600 million.

In dealing with the capital gains tax it is important to notice that the authors of the White Paper have chosen two systems, one of which is to take capital gains and treat it as ordinary income to be taxed at full rates. Given the ideal evolution which will arise when the White Paper is fully operative, the maximum rates are 50 per cent. Today, however, they are 80 per cent or, to be precise, 81.6 per cent. They are not immediately changed to 50 per cent, if they are ever changed, but move downward on a gradual basis over a period of time. Therefore we have a tax rate as high as 80 per cent applicable to capital gains, where today the rate is zero. I am not suggesting that the rate ought to be zero; our group is in favour of a capital gains tax. We recognize its necessity and inevitability, but are also pleading for moderation and reasonableness in its application. To move from zero to 81.6 per cent in one legislative stroke is a very drastic change and the very depth of that change should cause us all to pause.

There is another system of capital gains proposed for shareholders of widely-held Canadian corporations. In this regard it is recommended that the rates be half. In so far as the real estate and housing industry is concerned, we are not in this favoured group of the widely-held Canadian corporations. As home owners or owners of real estate, immovable property, we would be subject to the maximum rate, whether 50 per cent or 80 per cent, and not entitled to half the rate as widely-held Canadian corporations.

Senator Connolly (Ottawa West): Would you say that again?

Mr. Vineberg: We are subject to the general rates, the maximum today being 81.6 per cent. However, shareholders of widely-held Canadian corporations, as distinct from the owners of a painting, a home, an apartment building or an office building are subject to half rates. The way in which the White Paper is formulated makes that exception in favour only of the shareholders of widely-held Canadian corporations. It says some things, such as homes and certains types of assets located in Canada, might be treated differently, but they chose to draw the line on the basis of a widely-held Canadian corporation.

With that as a preliminary, I would like to turn to the first main point before us, the question of homes. The White Paper records a universal feeling that home ownership is part of the Canadian way of life. The papers published by the department responsible for housing, which are cited in the brief, indicate that there are almost 3,500,000 home owners in Canada, 3,500,000 families owning their

own homes. Moreover, the White Paper states that gain on the sale of homes should not normally be taxed. Therefore it is acknowledged that basically, as a matter of principle, there ought not to be a tax on the sale of any home.

When the United Kingdom embarked upon its capital gains tax—and I need hardly remind honourable senators that the United Kingdom had a much more mature economy, much less dynamic in nature, under economic circumstances very different from that of Canada—even then they only entered into a capital gains tax at two separate stages. One was to deal with and tax short term capital gains. The second stage was to later introduce a general capital gains tax. In the same way as the people who wrote the White Paper they said a man should not be subject to a gain on the sale of his principal residence being taxed. However, the English have a more direct way of dealing with it. They said, and put it into their law, very simply, if you sell your principal residence the capital gain is not subject to tax. What could be simpler than that? If you want to except a gain on the sale of principal residences, say so. The English, with their command of the English language, said so. The White Paper says "Oh, no; we have got to work out a long, involved, complicated, harassing, cumbersome, awkward and indirect method. This will be designed to achieve a result where in most cases when a principal residence in sold there will not be any tax. As a matter of fact, if we are very lucky it will lead to a situation where it will never tax the sale of a home.

The Minister of Finance said to the House of Commons committee dealing with this subject, at their opening meeting, that it is not intended to tax the sale on an ordinary home. Well, if it is not intended to tax the sale on an ordinary home, what is the White Paper proposing? They say a device should be worked out, involving the notion that there should be an allowance of $1,000 a year. That $1,000 a year is the same whether dealing with a home costing $15,000 or $50,000; it is the same whether the cost of living is going up at a fantastic rate, stationary or declining; it is the same whether the value of money has gone down the equivalent of $1,000 or $5,000; it is the same whether we are dealing with the market in Toronto, where the price of homes is going up a great deal, or whether we are dealing, unfortunately, in Montreal where it is not.

Senator Connolly (Ottawa West): That will change.

Mr. Vineberg: I think it will, senator, as of this morning, and I am happy to say so. But even the change is something that cannot be predicted by the authors of the White Paper. These political or economic changes are completely unpredictable. The authors say we should take the unpredictable, take an average of $1,000 a year, and they will allow a deduction for whatever improvements are made; if an extra storey is added, a new roof put on or the home is materially altered, that will be allowed, because they do not want Canadians to become a nation of bookkeepers; so if Canadians do not want to keep books, they will give everybody an allowance of $150 a year, which is in lieu of capital improvements that may be made. That allowance is available whether it is spent or not spent; it is available whether $10, $1,500 or $15,000 of it are spent on the improvements. It is a rough and ready rule of thumb method designed by happenstance to achieve a state of affairs where, by luck, good breaks, and unpredictable circumstances it may turn out that the objective of the White Paper will be achieved, that in some cases the sale of homes will not be subject to capital gains tax.

I would ask honourable senators to compare that with the situation that would arise if the law were to say, on the English model, that gains on the sales of principal residences should be tax free. Obviously you may ask why it is that the White Paper goes to these great lengths. The Minister of Finance has made two observations on that score. First, it is said that a gain on the sale of a principal residence falling into the category of something tax free would leave a loophole for wealthy investors. With the greatest respect, we would submit that a wealthy investor cannot collect principal residences; he may collect objects of art, valuable stamps, paintings and the like, but by definition a principal residence is unique; there is no collection of it. There is implicit the notion that somebody will pretend he has a principal residence that he does not have today. I think it would be useful to realize that real estate speculation is the most highly taxable thing there is under the existing system before the adoption of a capital gains tax. People who have masqueraded under the pretence that something is a home in order to try to realize a gain on real estate have been taxed. The Carter Report was very quick to point out that in the courts and in administrative prac-

tice real estate gains with the slightest speculative tinge, even without any change in the law, would be highly taxable.

We anticipate the probability or possibility of a capital gains tax. Obviously if a man buys half-a-dozen principal residences with the notion of gain, or even if he buys a single residence with the idea of gain, he should be subject to tax. It is only the bona fide principal residence that would be involved. Any contrived method would be subject to tax. Moreover, even without any change in the law, a quick turnover of real estate, even if it appears as a principal residence, might be presumed to be an actual speculative operation.

The second reason advanced is that a principal residence ought really not to be taxed, that once in a while because of zoning changes, or some very extreme situation, somebody with a fairly large area of land surrounding his principal residence may make a rather spectacular gain, and it is not fair to try to leave that gain untaxed. Probably it is not fair. However, if you think of the three and a half million homes in Canada and the small likelihood of these spectacular gains, remembering that we are only talking of a principal residence, not of great estates or lands or holdings as distinct from principal residence, it is obviously a case of the tail wagging the dog. Because of one situation in 100,000 or one in a million we must contrive a very laborious, creepy, expensive system to achieve an objective that can be much more readily and clearly achieved by the direct notion of leaving principal residences gains untaxed.

Senator Laird: Perhaps I could interrupt Mr. Vineberg at this point. From the resources of your organization, have you been able to project in any fashion what tax would be produced if the White Paper proposals were implemented? My impression, frankly is that it would be peanuts.

Mr. Vineberg: We are prepared to accept the statement in the White Paper that the revenue would be zero. As a matter of fact, it is perfectly apparent that the revenue after cost of administration would be less than zero.

Senator Laird: Then why bother with the tax?

Mr. Vineberg: That is exactly our point.

Senator Laird: Speaking personally, that is the way I feel about it, and I do not think you will find any disagreement among the rest of the committee.

Mr. Vineberg: You have said it much more concisely, but that is exactly our point. As far as revenue is concerned, there is not a dollar involved. As a matter of fact, they do not pretend there is. They say they are not trying to tax principal gains, but they want to try by this rather indirect and happenstance method to make sure that nobody gets away with unusual gains. I might point out that these things are as unusual as lottery winnings, and perhaps in the interests of being practical the White Paper suggests that lottery gains be untaxed.

Senator White: You mention that the revenue would be zero. If you took out the principal residences, as you call them, would there be any revenue then? The principal residences would not be taxable, but other real estate would be subject to capital gains tax. Would there be any revenue?

Mr. Vineberg: You are now speaking about real estate like apartment buildings, offices?

Senator White: Second residences and all that kind of thing.

Mr. Vineberg: Yes, we think there probably would be. It has been estimated there would be, although I think it is very hard to say exactly how much.

Senator White: Nominal?

Mr. Vineberg: A fair amount of this is already taxable because of the recapture of capital cost allowances, which have been in existence for 20 years or so, so it is hard to say. Then it depends upon the events of the future, whether prices go up or down. I would not judge that an enormous amount of money would be involved either way.

Senator Connolly (Ottawa West): Mr. Vineberg, I think you are exclusing the case of people who are in the business of building and owning family units, whether they be multiple or single, but who are obviously in that business.

Mr. Vineberg: Absolutely, Senator Connolly. Actually they are taxable today even without changes in the tax law, and we contemplate they will be taxable in the future; there will be no relaxation.

Senator Laird: One finds out the hard way.

Mr. Vineberg: They are taxable the most, and it is not recognized even now, without a change of the law that that should be a capital gain. The brief outlines a number of inconveniences of the proposed system which seems to be so overwhelming, just to emphasize the point made by Senator Laird a moment ago.

First of all we have the problem of valuation with almost $3\frac{1}{2}$ million homes. There are $3\frac{1}{2}$ million valuation problems, because the White Paper is not intending to tax again on the increase and value from date of original cost, but only from the valuation date. It is theoretically and potentially necessary to value $3\frac{1}{2}$ million homes. That is a formidable fare. It is not to be compared with valuations of substantial stocks on the stock exchange, because there the valuation is automatic. When the day comes you look at the quotation of the Toronto, Montreal or New York stock exchange and that governs. When it comes to homes there is no stock exchange. Moreover, we are not dealing with a business where there will be an accounting kept of a balance sheet, profit and loss, surplus and where the tax records would show when it comes necessary at a time of a future sale to analyze just what the financial position has been.

The valuation is of no consequence unless and until the homeowner sells his home. He does not need evaluation as such on D-day. He needs it if and when he sells his home.

The Chairman: Mr. Vineberg, in that context I wonder if you would like to read paragraph 36 of the submission into the record and then perhaps comment on it.

Mr. Vineberg: Yes sir.

> The taxpayer who does incur the expense of a professional valuation, must do so without any advance knowledge that the expense involved will ever achieve any purpose because it will be impossible for him to foretell whether at the time of ultimate resale his home has fallen into the category of the 'ordinary' or 'extraordinary'. Furthermore, he must not only preserve the valuation but pray for the preservation of the valuator! If the latter be dead or unavailable by the time the report is to be used, it will not be admissible testimony.

The valuation is unusual in this sense that the normal taxpayer files his returns and the tax inspectors come around the next year, the year after, three years later, but at most four years later, because there is a statute of limitation. They will say, "Let us see your records on this particular point." The records are pulled out and presented. There will be cases when the owner will sell his house a year after valuation or two or three years later. The average owner sells his house four years later. There are people who hold their homes twenty, thirty, or forty years. After the owner has held his home for thirty years from valuation day the experts come around and say, "What was the value of this house thirty years ago in 1971?" The physical house will be difficult to identify and it would hardly be the same. If he does not have a professional valuation it will be very difficult for him to contend for any one figure or another. Moreover, even if he has a professional valuation you cannot, in a manner of legal testimony, present an opinion of an expert without presenting the expert, because of the rule that you cannot examine a document. The expert testimony must be subject to cross-examination. Therefore, if the evaluator in the intervening thirty years has died or is unable to express himself it would follow that the taxpayer is bereft of all evidence.

That, in itself might not be so bad, but there is a rule that a taxpayer is bound by an assessment unless he can prove the contrary. The onus of proof is always on him. He must upset that. It therefore follows that whatever figure is imposed by the tax department will prevail, absent the possibility of a taxpayer opposing it.

Senator Connolly (Ottawa West): Wouldn't you think in a case like that, that they would have a regulation to the effect that if you had a professional valuation in a given time and if it was not possible to produce the man who made the valuation, because of death or lapse of time, that the document itself might be admissible. It seems to me that that could be expected.

Mr. Vineberg: I would hope so, senator. I think it might well happen inevitably that they will relax the ordinary rules of evidence under those circumstances and say that they will have to accept or that they would be inclined or prepared to accept.

Senator Connolly (Ottawa West): I think the point is made for the record. In the interest of having that recognized if perchance this rule about the taxation of capital gains should be...

The Acting Chairman: It seems to me, Senator Connolly, that the point is merely to

add to the whole concept of uncertainty that surrounds the sale and ownership of private homes.

Mr. Vineberg: It is a combination of cumulative factors. Here is a proposition that ordinary homes should not be taxed. A man owns what he considers to be an ordinary home and holds on to it and has to decide whether he should get an evaluation. Well, an evaluation costs money and would he be able to understand that it is worth doing and will the cost of the evaluation be a deductible expense? Will the $1,000 be sufficient? This is all very obscure. It would be difficult to know whether to advise him to get evaluation or not.

Senator Laird: You are really in a sense talking or arguing now against the selfish interests of your own clients. There must be plenty of appraisers in that group.

Mr. Vineberg: I am even arguing against the interests of lawyers.

Senator Molson: That is going too far.

Senator Laird: We put thumbs down on that.

Mr. Vineberg: I have fought the most interesting cases on evaluation.

Senator Molson: Mr. Vineberg mentioned the possibility of 3.5 million evaluations. That is based on principle residences of families. I would think that if the White Paper were adopted the number of evaluations would probably exceed that by perhaps double or several times, because there are so many other things to be valued. In fact, I think the people who will definitely make money out of the White Paper would be those who set up evaluation firms from St. John's, Newfoundland to Victoria and are ready for V Day when it comes.

Mr. Vineberg: I think the bill might be renamed the Act to Subsidize the Valuation.

Senator Laird: And lawyers.

Senator Connolly (Ottawa West): There is one other point I would appreciate your touching upon. I think it is a point that is of concern and of interest, certainly to Canadians generally. The law talks generally about a principal place of residence. In this country many people, regardless of what their income bracket is, have a place in the country. They have a summer cottage. It is not for the most part an elaborate place but very often it is sold at a profit, and I am wondering whether the principal place of residence is necessarily one house, because of our way of life here.

Mr. Vineberg: Senator, some of our members and constituent organizations have raised those problems in separate briefs which they will submit to you. It is arguable and has been argued that a country home, especially in these days of stress and strain and polluted cities and the like, is a healthy necessity of life, and that a strong case could be made for the exemption of the country home or the second dwelling. We are not in our brief taking a stand on that one way or the other. We are not saying they should or should not be taxed. We are not making any special plea on that score. We feel the case on the principal residence is overwhelming. We think that is acknowledged in the White Paper and that the onus of trying to tax it should be on those who want to do so; whereas, within the ambit of the theory of capital gains tax, while there is a strong case as well for exemption of a second home, we don't think it is as overwhelming and we have not included it in our representations one way or the other.

I should say that a number of our members and constituent organizations have stressed that point and will be dealing with it in separate briefs.

Senator Connolly (Ottawa West): I would not go so far as to suggest that a place in the West Indies or Florida should necessarily be included, although there are people who sometimes must go to such places because of health, and perhaps even at an early age. Primarily I think of a place in the country outside of the big urban centres of Canada, and not necessarily an expensive place or an elaborate place, but one upon which gains could be made. It seems to me to be part of the family residence, even if it is only for six or eight weeks of the year.

Mr. Vineberg: On the whole question of the taxation of real estate, I must say that real estate is particularly heavily taxed with respect to local municipal assessments. The White Paper makes the point that there has been a proliferation of heavy taxation at the municipal level on all real estate. Moreover, real estate is subject to estate tax and, unlike the more mobile stocks, it is always cited in Canada and in the particular province where the tax is going to be imposed. So between municipal taxes every year at the one end and the estate taxes at death at the other end there is a considerable tax on all real estate,

and that can well be considered on a special valuation of the income tax in that area.

Senator Blois: Reference was made to the ownership of places in the West Indies or in Florida. Would the capital gains from selling such property be subject to tax in Canada if the owner sold it to somebody down there?

Mr. Vineberg: Under the White Paper, yes. The Canadian taxpayer is subject to tax on his world income, and under the White Paper the same thing would apply to capital gains. It would make no difference where the property was located or where the buyer was. So long as you made a gain it would be taxable. That is the theory of the White Paper and it is not inconsistent with the general theory of the income tax. If an individual makes a profit by operating a store in Nassau, for example, he is subject to tax in Canada on that income. If he made a capital gain he would be subject to tax on that as well. There would not be anything unusual about that.

Senator Molson: Mr. Chairman, early in his presentation Mr. Vineberg said the association was in favour of capital gains tax, recognizing the inevitability of it. I think that was his expression. I should like to ask him to clarify that slightly. Is the association in favour of a capital gains tax in principle or is it only in favour of accepting the inevitability of it?

Mr. Vineberg: It is in favour of it in the negative sense of the term. The association regards capital gains tax as inevitable and that from the viewpoint of equity a modest, reasonable measure, relatively, of capital gains tax is, theoretically, a defensible imposition. We do not believe it will raise any particular money. We are also discouraged by the disincentives that it creates—the impact on the economy and on savings. We are particularly opposed to capital gains being assimilated in income and being taxed as though it were income. Our organization is not saying to you that it is against all capital gains tax under all circumstances. On the contrary. If the capital gains tax were reduced to a position sufficiently below the American tax rate that it would place us in a competitive position and were introduced in stages and in moderation, then the Canadian economy, so we believe, could sustain it, and the theoretical argument of equity could justify it.

Senator Molson: Do you believe the Canadian public is now ready to see that form of taxation?

Mr. Vineberg: That is right, possibly by comparison with the alternatives to which they have been subjected in their exposure to arguments recently.

Senator Connolly (Ottawa West): Would you go further on that point, Mr. Vineberg? You say you are in favour of capital gains, or that you bow to the inevitable in respect of capital gains. Do you think the gain should be taxed by incorporation at the top of the income that is received by the individual or should capital gains be subject to a special act somewhat the same as the United States act?

Mr. Vineberg: We all feel it is most unfair and improper to incorporate them at income at the top bracket. Something might be said for very short-term capital gains, say, six months of the year. But when you have a capital gain accrued over a period of time, it is usually a part of the product of inflation, and the presently proposed system with respect to capital gains would be a most unfair one because inevitably it would place the taxpayer at the highest possible bracket. As we have said, the averaging is most inadequately dealt with and does not take account of the accrual over a period of time. Moreover, the subjection of the tax to the maximum rates is, in our view, horrendous and undesirable from the general social viewpoint as well as from the viewpoint of the economy of the country.

We would feel otherwise that, if there was a lower rate and a special classification of capital gains, it might be measured on the basis of the time over which the asset was held, or by some other means, so that we don't have the present argument. We think it should be treated differently from income because there is a basic difference between income on the one hand and capital gains on the other hand.

The Acting Chairman: Just to clarify that matter in my mind, Mr. Vineberg, may I say that we have had it represented to us that either capital gains should be taxed at half the income rate or that half the gain should be taxed. The net result of that is a lower rate. It means that it is still part of income and, therefore, the gain in a year is at the top marginal rate. The loss in a year is at a lower rate and, as you have indicated in your brief, the averaging provisions are not worth very much and are worth nothing where a reduction in income follows a high average income.

You are now making the statement that it is wrong to tie them to income. Are you then

saying that the capital gains tax should be a tax entirely separate from the income tax?

Mr. Vineberg: Not necessarily. There is a very important element of progressivity in the income tax brackets, although that progressivity is much narrowed under the White Paper because the exemptions have been raised and the maximum rates are being reduced from 80 to 50 per cent. The rates are decreased downwards. If you have a flat rate of capital gains tax like 20 or 25 per cent, that may be rather unfair for people who are in the lower brackets and for somebody who is earning $10,000 a year and who has made a thousand dollars or so on the stock market. I am personally inclined to think that perhaps a flat rate of tax for such a person would be unfair, and that you might combine the two and that it might be the lower of what the tax would be if it was ordinary income, or it might be half the rate or something of that kind, so that there is some element of progressivity which should remain even for capital gains tax. A high proportion of capital gains are earned by people in relatively lower brackets.

Senator Molson: That is the American system.

Mr. Vineberg: That's right.

Senator Molson: They have an alternative.

Mr. Vineberg: I think something of that kind, without going into detail, is essentially desirable.

The Acting Chairman: But isn't the American system based on the fact that there is a separate capital gains tax, which is the upper limit, and the income tax is available to you if indeed the rate on income tax is lower than the separated tax?

Mr. Vineberg: Yes, indeed. I think we all have in mind something along those lines, that is to say whatever the nomenclature you will have to distinguish between capital gains and income tax, and therefore there will be a separate capital gains tax. But I do not exclude some element of progressivity in the capital gains tax, particularly in the light of smaller capital gains by persons in the lower tax brackets.

The Acting Chairman: But do you think it should have a maximum?

Mr. Vineberg: Yes.

The Acting Chairman: That is not tied to income?

Mr. Vineberg: Yes, I do, but of course even income tax has a maximum, whether it be 100 per cent, 50 per cent as proposed in the White Paper, or 80 per cent as it is at the present time.

The Acting Chairman: I am thinking specifically of the inability of the income averaging positions to take care of a gain in one year, no gain in the next year, and a loss in the next year, and then a gain again in the following year.

Mr. Vineberg: And all the other factors like inflation and the difference between making a sale of something that you have held for 15 years and something that you have held for three years. I think all these factors contribute to supporting the idea that there should be some combination of factors distinguishing capital gains tax from the income tax, and imposing it at a different level, whether by taxing half of it or by having it at half the tax rate—I don't think there is too much difference.

Senator Connolly (Ottawa West): You are aware of the complication that is in the Tax Act. I think that if there is to be a capital gains, and it seems to me that this is what Senator Everett is suggesting, would it not be a sensible approach to have a separate capital gains tax act and if there has to be a cross-reference, integration in some respects with the Income Tax Act could be done, but it seems to me it should be treated as two different categories by two different pieces of legislation. It seems to me the Chairman suggested that this is the appropriate way, and I gather you agree.

Mr. Vineberg: Yes, whether you need a separate act or not, that is a matter of preference. After all a gift tax provision falls under the Income Tax Act, although a gift tax is essentially very different from income tax.

Senator Connolly (Ottawa West): Which does not necessarily mean that that is the right place to have it.

Mr. Vineberg: No, not at all.

Senator Connolly (Ottawa West): It seems to grow just like Topsy; they put them in one year and all of a sudden you find yourself with a huge body of law.

Mr. Vineberg: That's right. Honourable senators will notice that the White Paper does

make one special distinction about principal residences, and in this case it treats the principal residents much worse than it does the ordinary capital gain. If you make a capital gain on the sale of shares, it is taxable, says the White Paper, but if you make a loss, it is deductible, and of course people will possibly have a portfolio of shares and a multiplicity of holdings, and at the end of the year they will probably scan through their portfolio, and the White Paper assumes this, look at those stocks that have gone down in value, realize the loss and deduct it. But the White Paper says principal residences are special; if you suffer a loss on the sale of the principal residence, you cannot deduct it. So there is an acknowledgement that you have to treat principal residences differently, and in this area the acknowledgement is based upon, and I quote—"practical considerations". There is no introduction of any elaborate reckoning. Now if you have a loss that exceeds $1,000 per annum or if you have a loss that exceeds $1,150 per annum or if you have a loss that exceeds some formula, they simply say categorically "a loss is impractical for us to consider.

When you are losing money, let us be practical. You have sold your home at a loss, that is too bad, and you cannot deduct it from income." If you sell on the stock exchange the most speculative securities, and you suffer a loss, that is deductible. But we have to be practical about this thing. It would be a very, very complicated business, and, Mr. Chairman, we agree it would be. But it is just as complicated a business in relationship to losses as it is to profits and exactly the same practical considerations which have motivated the proponents of the White Paper to say "let us forget all about the losses when a man sells his home" ought to apply when he makes a profit.

Now, there is an incidental aspect, because I have been running through all the extraordinary troubles that arise by the taxation of gains on a principal asset—there is an incidental aspect that is not considered here in the White Paper. If a businessman in relationship to a capital asset, the operation of his business—machinery, equipment—if he incurs a debt and pays interest on it or if he makes repairs or if he has ordinary carrying charges, they are deductible. When in the end he is subject to a gain, he will have been able to deduct all the offsetting carrying costs. What happens to a principal residence? The White Paper is silent. If the principal residence is looked at as a capital asset in the years to come, when the taxpayer makes his reckoning, will he be allowed to deduct the interest he has paid on his mortgage? The answer is either yes or no. If the answer is yes, what a complication that is going to be. And he should have been allowed to deduct it year by year, like the businessman because that is when the businessman deducts it.

Senator Connolly (Ottawa West): And the cost of getting the mortgage.

Mr. Vineberg: Yes, and the cost of getting the mortgage. Then if the answer is no, how do you possibly justify treating the home owner on his capital gain much worse than you treat everybody else on their capital gain. Is there to be a special disability because this is a home? Or because it is impractical to draw the distinction? And it is not just the interest. If you put on a new roof or you introduce a new lawn, they will allow capital expenditures. But what about the year-to-year reductions? Why should they not be allowed in the year in which you have expended them? But, the White Paper would say "you cannot tell which part of the home is being used and which part is an investment—the two are inextricably bound up with each other" and then it would say in effect "let us be practical and forget all about it." But I think that what applies on the negative side applies equally on the positive side.

I do not think I need to say anything about record-keeping. The amount of record-keeping that would be required in this situation, especially as the home might be sold so many years later, would be absolutely phenomenal and the nation which is not to be a nation of bookkeepers would become a nation of record-keepers. They would be wise in their own protection to keep inexhaustible records.

Senator Connolly (Ottawa West): Would you care to say something about the magic figure of $150?

Mr. Vineberg: Well, I don't regard it as a magic figure or a reasonable figure. It is a kind of accidental figure that will fit a very small percentage of the cases.

Senator Connolly (Ottawa West): Let us take a very practical illustration. Suppose there is a major plumbing job to be done on your house, and I was looking at television the other night which had to do with a plumber's charges per hour which now amounts to about $10 an hour apart from overtime. Now

that would not take very long to run up to $150. Then if you had to fix the roof as well or fix your sidewalk or fix your lawn as well, then that $150 is very close to peanuts at today's prices.

Mr. Vineberg: It seems to me there is a vast area of controversy involved at that stage. Of course nobody could afford to fight it; you would have to accept whatever they said. They might say that that $150 for plumbing has nothing at all to do with an improvement of the home—that is ordinary maintenance because the tap has sprung a leak or something of that kind and in the end result you only get exctly what you had before and there is no permanent improvement. If you took out a boiler and replaced it with another one, we will admit that is an improvement, but if you repair the boiler, that is something which is an ordinary expense that ought not to be deductible. That whole area, which is a subject of controversy, would be a matter of debate between the administration and the homeowners, to a degree that would be shocking in relationship to the lack of revenue that would be involved.

Senator Connolly (Ottawa West): I do not want to get into a long discussion on this point, but does not the American law give better recognition than perhaps under this White Paper?

Mr. Vineberg: Yes, the American law allows annual deductibility of taxes on the home and expenses and the like. They are very generous in that respect, and there is nothing like it in the White Paper at all.

We have also pointed out the international migration problems that are bad under the White Paper, which would at least be alleviated if the White Paper would acknowledge that the principal residence should not be subject to it.

Honourable senators will have noticed that it is not only the sale of the principal residence that is taxed, but even the gift of the principal residence, because there is a general rule on gifting that any gift is the equivalent of a sale for purposes of capital gain. It would follow that if a father were to give his home to a son, or a husband to a wife, such a gift would invite immediate taxation if the value of the house at the moment of the gift exceeded valuation day value plus the $1,150 per annum in the interval.

We have pointed out in our brief that this is in itself unfair, vexatious, unnecessary—and doubly unfair in relationship to Quebec and the debate in the Senate on the application of the gift tax measures which were adopted effective October 22, 1968 in relation to the Province of Quebec. At that time Quebec law did not permit transfers between husband and wife, because of the special provisions of the Civil Code; and when there was an objection taken it was suggested that, after all, Quebec could change the law. Well, in the event they did. The law has been changed effective this coming July, and as of July and August a Quebec husband, for the first time, could make a transfer to his wife, which he could not have done before, in order to put the home in her name for shelter or protection. But if he does so after the White Paper is operative, he may well become subject to a whopping big tax because the transfer is regarded as the equivalent of a sale, and the differential is completely taxable. The most anomalous result would follow, that after the debate in which the Government has taken the position, "Well, all we have to do is change the law and make the transfers," they would unintentionally propose to make the transfers taxable.

With all this, honourable senators, it is our position that you have two alternatives: one is to follow the philosophy of the White Paper, which says the sale of principal residences should not ordinarily be taxed, and to follow it to its logical conclusion and say so in the law which will give effect to it; and the other is to embark upon a tortuous, costly, intolerable, vexatious, round-about, slip-shod, administratively deficit-inspired formula, which cannot possibly achieve the same results and which is bound to create much more confusion, a vast body of law, a fantastic amount of loopholes, all kinds of administrative problems, to no end or purpose whatsoever.

It seems to me that the English have discovered the correct way of dealing with this, and that we ought, with respect, to follow it as a very clear alternative by comparison with anything else.

The next area, if I may be allowed to raise it, honourable senators, is that dealing with capital cost allowances.

The Acting Chairman: Mr. Vineberg, I do not want to rush you unnecessarily. I just remind you we have five groups of witnesses to deal with today, but we want you to make all your points, of course.

Mr. Vineberg: All right, I will try to be brief.

Senator Connolly (Ottawa West): You have done a magnificent job on this.

Mr. Vineberg: Thank you very much, Senator Connolly.

On the capital cost allowances, honourable senators, the basic point that we make is that the White Paper says, "This has served Canada well; it is a good system. Although we may look into it in the future, this is no time to do it." Then, having said that, they say, "Ah, yes, but in one area, particularly in relationship to real estate, we have to do three things, we have to correct three 'loopholes'."

The essence of the capital cost allowance system was introduced in 1949 when the rates were doubled to create and incentive, and the complaint today in the White Paper is that the incentive has worked, that sometimes people make investments that they would not have made had it not been for capital cost allowances. That is the purpose of the capital cost allowance system, to encourage people to make investments. There is a built-in encouragement device and, as I say, all the while saying that, "We will accept this as a magnificent system which has served Canada well," they turn to real estate and say, "In your case, we want to make three changes."

The first of these is the notion that, while in all other spheres you take the aggregate of your losses and profits, if you have losses from real estate you must not deduct them—particularly if those losses arise from the capital cost allowance or interest and the like. That is a rather peculiar approach.

There was a time, pre-1949, when they said, "You must not have taxable income lower than income from your main source." That is a tolerable argument, but they are proposing to make a unique exception for real estate.

What is there about real estate? You will be later hearing from the construction industry, and you know the enormous contribution that the industry makes to employment and the Gross National Product. There are over half a million people engaged in the industry. Are there too many people employed? Is there too much building? Elsewhere we quote the need for residences. Are there too many homes? Are there too many dwellings? It seems that the complaint is that some people may build apartments, some people may build buildings which they would not otherwise do. This is exactly what was intended by the capital cost allowance system, and to object to it on that score is to torpedo it.

Secondly, they want to create a separate class for each property worth over $50,000. For all practical purposes, to an investor that means every property.

I think our brief points out that this will create a special "loop-hole," to use a popular word now, for wealthy investors. If they have any properties that have gone down, they can now take terminal losses under the White Paper, so if they have many buildings they will be able to write those off because any building that has gone down in value can be sold and a terminal loss created. Whereas those who have only one building will be subject to extra hazards.

The Chairman: Could I interrupt you there, Mr. Vineberg? Could you give us more detail on that particular manœuvre?

Mr. Vineberg: Yes. Let me take this as an illustration. If you are an individual investor with a single building, you have no choice; but supposing you have 10 buildings and you buy a building for $1 million, and you have written it down to $950,000. It is a bad area in that particular part of the country, with many vacancies. It is only worth $800,000 by reason of the vacancies or by reason of the fact it is in a part of the country which is suffering or where the prospects are not so good. You could sell that property and take $150,000 loss because you now have a right to a terminal loss in view of the fact that that apartment building is a separate class.

Today you would not be allowed to take that loss. You would be allowed to take that $150,000 and add it to the depreciation available on the other buildings, but you would not be allowed a particular terminal loss. Whereas this systems is going to create deliberate terminal losses, where you will be able to write off where you have a vast number of properties. So, it can work both ways. The authors of the White Paper do not realize that values are coming down.

The most singular change, we think, is the one that is directed at death—the capital cost allowance changes there. We feel that that is completely unjustified. Nobody dies for tax-giving purposes, and there is no reason to penalize the heirs in respect of capital cost allowances which they have never taken, and which relate to the income of the deceased.

We submit that the three changes in respect of capital cost which are specially directed at the real estate industry ought not to be adopted at all, or, at the very least, as the White Paper says: The capital cost allowance system is a wonderful system. We will look at it later, but if we look at it later we ought to look at these changes later when the whole system is being evaluated, rather than impose this particular tax against the capital cost allowance system which is an important incentive for employment and for the gross national product, and, above all, for our industry in respect of dwellings for the Canadian people.

I refer to the capital cost allowance system as an important argument, which is not unique to real estate and which undoubtedly you have heard elsewhere, in respect of creditable taxes. The whole system of creditable taxes is based upon the amount of taxes that a corporation will pay in terms of Canadian taxes. No doubt they had in mind Canadian taxes by comparison with American and non-Canadian taxes, but another point has emerged on analysis. We have a series of rules such as those on capital cost allowance designed to encourage construction. They are there for that purpose. If you do a lot of building you will be given additional capital cost allowance, but the more encouragement a company has on capital cost allowance the less will be its Canadian tax because it has huge depreciation allowances, and the less will be the creditable tax available to the shareholder.

We have the following result, in real estate terms. A shareholder in a company that, let us say, is simply in land speculation—it is not interested in doing any development, or building, or employing, or anything like that—is in an advantageous position because that company will pay Canadian taxes which will be maximum creditable taxes. When the shareholder gets his dividend it will be completely tax-free, or it will entitle him to a refund, depending upon what bracket he is in.

Contrast that company with another company that owns a similar block of land and that says: "Let us put up some buildings." They do not do that out of altruistic motives. They think it is good business. In the notion of good business is the fact that they will get capital cost allowance. There is the incidental impact on the economy of the country in that people will be employed, and apartments and dwellings will be secured for society. These are social advantages. The shareholder in the second company is at a great disadvantage because his company will not be paying as much Canadian tax because of the fact of the capital cost allowance, and his dividends or his distributions will, therefore, not entitle him to the same amount of creditable taxes.

The result is that we have a system evolved in 1949 which has served Canada well—it has given encouragement by way of capital cost allowance—and a system proposed in 1969 which has not served Canada yet, which is completely unrelated to it, which is unintegrated with it, and which is incompatible with it. The whole integration system proposes to deal with matters in a way that runs at exact cross purposes with incentives like capital cost allowances. Honourable senators will appreciate that there are other areas as well, but in real estate we particularly feel that that applies to capital cost allowance.

We have a section on non-resident investment. If honourable senators agree I will skip that because the brief speaks for itself. I can say the same about interest charges.

Finally, there is a general section on expenses. We believe that that has to be dealt with in a businesslike manner. We are not in favour of profligate, wild spending. We believe that the criteria that are presently in the law, and that are basically being enforced, are quite reasonable. The expense must be laid out to earn income, and the expense must be reasonable. The expense of attendance at conventions and matters of that kind are permissible deductions, not because they are spent on conventions but because they are spent to produce income.

It is not without irony that one section of the administration of the Income Tax Department—and it is the section which deals with enforcement—is at this very moment meeting in convention—they may not call it that—somewhere in the Laurentiens. The tax assessors are meeting each other in order to talk to each other and to compare notes, and to instruct each other on the most appropriate ways of proceeding. No one would think that they were doing this as a tax gimmick, or because the expense is deductible. The Government of Canada considers it to be good business for its operation.

Senator Connolly (Ottawa West): And pays for it.

Mr. Vineberg: Yes. Last week I was at a Quebec Bar meeting at a Laurentien resort, and at the same resort there was a large

group from Air Canada, a Crown Corporation, solemnly meeting throughout the entire day, as we were. They were not doing it because the expense was deductible. They must have been doing it because they thought it was good business. There are no tax considerations to motivate Air Canada in sending its men up to the Laurentiens. They felt it was good business.

Our industry feels that expenditures on conventions and otherwise are very good business. We do not have the possibility of selling in a way that other people do. We must go out and sell on a promotional basis, and the more active and busier we are, and the more we spend, then the more the results, and we think that a proper businesslike approach should be taken in respect of this matter.

Senator Laird: Mr. Vineberg, we spent $1 million through the Canadian Government Travel Bureau to attract businessmen to the very facilities which we are now trying to tax out of existence. Does that make sense to you?

Mr. Vineberg: No, it does not.

Mr. Chairman, unless you want me to say something else, I do not think there is anything further I have to say, and I thank you and the members of the committee for the time you have given us.

The Acting Chairman: Thank you, Mr. Vineberg. Has any other member of your delegation anything to say ?

Mr. McFarlane: Perhaps I might just add, as was pointed out earlier, that we did not make the question of the secondary residence—the summer cottage—part of our submission. We did not wish to muddy the waters of our brief in respect of the principal residence. But, we do feel that many of the same arguments that we have made in respect of the principal residence can be applied to the secondary residence. There are other areas, such as the welfare of recreational communities, that are deply and seriously involved when one considers the aspect of secondary residences. I just wish to mention that for the record.

Senator White: Mr. Vineberg, cannot a man have two principal residences? Modern methods of transportation allow people to spend six months in the city and six months at his summer cottage.

Mr. Vineberg: Yes, I would think so, but I would think that the draftsmen of the law would probably be inspired to draft the principal residence on the basis of exclusivity or selectivity, but that is a matter of philosophy. You could have more than one principal residence. In these mobile times that is becoming increasingly common in respect of businessmen, quite apart from any question of a summer home.

Senator Laird: In connection with small corporations you seem rather reluctant to indicate that perhaps the existing law might be replaced satisfactorily with something else. I note that at page 66 you suggest:

> Perhaps consideration might be given to something akin to the obverse of the refundable tax which has been resorted to exceptionally at different times in our tax history. These corporations might be allowed an interest free defined time period during which some portion of the tax otherwise payable is deferred.

I suggest to you that that really is no solution to the problem of the small corporation, because it is only deferral.

Mr. Vineberg: I quite agree with you, senator. We would much prefer the earlier alternative of retaining the existing rules in favour of small corporations or devising some equivalent thereto.

In the event it is found to be inevitable or necessary to add something, we made a suggestion along those lines. In a way, even though in the present system it is deferred, it is only taxable on ultimate distribution.

The Acting Chairman: Would you explain that suggestion?

Mr. Vineberg: That we take the obverse of the existing situation as a way of increasing taxes. In the past there have been situations where the Government has proposed not a tax but a loan. You pay an extra amount to the Government and it is refunded. This was done during the earlier postwar period and again recently.

The small corporation may be told it has an obligation to the Canadian Government payable over the next few years, not today. It will be interest-free, unlike the refundable tax. Therefore, in the early days of a small corporation it will have a lower rate of tax, but will make up for it by paying deferred tax in later years.

I agree with Senator Laird, that it is by no means an ideal solution.

The Acting Chairman: Can you tell me how you propose to handle it so that there is creditability if depreciation does not reduce creditable tax?

Mr. Vineberg: I think we should do it as the French do it in the "avoir fiscal". That is, Canadian compagnies which are subject to Canadian tax should be fully qualified on distribution without any distinction as to whether they paid the tax.

The Acting Chairman: Whatever they distributed?

Mr. Vineberg: Yes; in my view the whole system is inferior to sections 28 and 38 of the Income Tax Act.

The Acting Chairman: I thank you, Mr. Vineberg, and your colleagues on behalf of the committee.

Senator Lazarus Phillips (*Acting Chairman*) in the Chair.

The Acting Chairman: Gentlemen, the next brief we propose to present for consideration is that of the Canadian Construction Association.

Mr. R. G. Saunders, President, Canadian Construction Association: Mr. Chairman and honourable senators: on behalf of the Canadian Construction Association we welcome the opportunity of presenting its views on the proposals contained in the White Paper on Tax Reform.

The Association particularly welcomes the approach taken by the Government in presenting its proposals for tax reform by means of a White Paper rather than as in the situation last year when we appeared before your committee in regard to the estate tax proposals, which were presented in bill form.

The Acting Chairman: We remember that.

Senator Molson: Very well.

Mr. Saunders: Thank you. We are here as representatives of construction employers, who are concerned with the impact of the White Paper proposals as they would affect the growth of our firms in the industry and that of our economy in general.

As described in our brief, the procedures we have followed and its preparation have resulted in recommendations which are widely representative of the consensus of the Canadian Construction Association and of its over 100 member associations. These have a total membership in excess of 12,000 firms. In the preparation of this brief we have attempted to develop practival alternatives to the White Paper proposals which have an adverse effect on construction operations.

As you will have noted, our brief has stressed the unique nature of construction operations and companies. Virtually all the contracting and supplying firms are family or closely-held corporations.

Because of the high risk nature of the industry most firms are incorporated as limited liability companies. They are typically short of liquid assets and dependent upon their own resources for capital expansion and capital growth. Even the large firms in the industry have a chronic working capital shortage, which in turn affects their ability to obtain surety bonds, which are so necessary for tendering and contract awards. In addition, our labour force is extremely mobile and many of our employees are in the middle income group, which is seriously affected by the income tax rates proposed in this White Paper.

Although the White Paper does not deal with estate and gift taxes, you will recall that we expressed to you last year our very great concern that the new schedule would place in jeopardy the continued operation of construction firms as they pass through the next generation. We stressed at that time that the amendments to the schedule of estate taxes should be deferred pending consideration of tax reforms to be included in the White Paper. It is now obvious that the fears of the Association were fully justified and that it is grossly unfair and unrealistic to impose the combined impact of the proposed capital gains tax and the periodic revaluation with the new estate and gift taxes.

Of almost equal importance to our smaller firms—who I might add comprise the bulk of our membership and the members of the industry—is the White Paper proposal to abolish the split rate of corporate income tax. We believe that this should be retained, or alternatively that a company should have the option of deferring payment of half the tax on the first $50,000 of income until dividends are distributed.

We would also particularly draw your attention to our recommendation No. 5 deal-

ing with the taxation of the middle income group, and to recommendation No. 8 on the carry back and carry forward of losses.

You will note, honourable senators, that we are not accompanied by legal counsel. We are here as practitioners within the industry, and all of us are prepared to enter into the discussion. We will be pleased to amplify our brief or answer any questions on any recommendations or comments contained in this submission.

The Acting Chairman: Thank you very much, Mr. Saunders. Would any of your colleagues or associates like to supplement your remarks before honourable senators may have questions to put to you?

Mr. Saunders: Would Mr. Bird or Mr. Stein have any complementary remarks to make on my introductory comments?

Mr. M. Stein, Immediate Past-President, Canadian Construction Association: Perhaps I might just stress something. Although we are very knowledgeable in construction matters, perhaps we are not quite as knowledgeable in the technicalities and fine points of taxation law. We are, however, fully aware of not only the technical problems in the actual construction operations, but also the human problems that relate to them. These are quite important, far more important than is often realized. Uncertainties and fear can very often have disastrous effects. I think we need only look at what happened in la belle province until the situation was clarified yesterday. These uncertainties, sometimes unjustified fears and sometimes justified fears, can have a tremendous impact. The uncertainties in the Province of Quebec recently have resulted in our province having the highest rate of unemployment in Canada, and probably the industry that has suffered most there has been the construction industry. That is all I have to say, Mr. Chairman.

The Acting Chairman: Thank you. I think, honourable senators, these gentlemen should be advised that we are seized of the conception that the members of their association can to a very considerable degree be classified as being in the small business group. This committee has been groping with the problem of what should be defined as a small business, and the various criteria of annual profits, sales and other considerations have come before us. Are you as an association able to assist this committee in expressing a view on what should be defined as a small business corporation or a small business enterprise, in terms of sales, profits or any other factor?

Mr. Saunders: I will ask Mr. Sandford if he will answer that question on behalf of the association.

Mr. K. V. Sandford, Taxation Officer, Canadian Construction Association: This problem was debated and fully considered at the various committee meetings we had. The conclusion was that to take a number, maybe $100,000, would eventually be taking a number out of the air, and that it would cause problems of administration to have different tax treatment of somebody on one side of the line from someone on just the other side of the line. The incentive would be always to be under the line. As an alternative we make our proposal on the rate of corporation income tax to allow deferral until distribution of dividends. We feel this would take care of the small business that is starting and has no intention of distributing dividends, but rather intends to build up internal working capital. At the same time this deferral incentive would not be given to the larger companies, who are in a more fluid position and intend to distribute dividends.

The Acting Chairman: Would you identify that on the page of your brief so that we can read your recommendation?

Mr. Saunders: It is recommendation No. 2 on page 2 of our summary.

The Acting Chairman: Where would we find it specifically?

Mr. Saunders: Page 20 in the body of the brief.

Senator Molson: What do you suggest would happen in the event the corporation paid no dividend but later on under section 105, if it existed, then made a distribution?

Mr. Sandford: We presume that section 105 would probably disappear and there would not be a distribution provision allowable, as they have under that section at the present time. Consideration was given to making some kind of a time limit maybe to force dividend distribution. That comes in with recommendation No. 3 respecting the two and a half year time limit suggested in the White Paper, which we think is unrealistic. In our deferral we do not impose a time limit. We put this idea forward for consideration. Ten years is probably the minimum time limit that should be imposed in either case, because

of the unique need for internal working capital by construction companies, who do not have access to the other sources of funds.

Senator Molson: This is a recommendation of yours, that if the White Paper becomes effective it should be dealt with in this way. But is this your preference as to the way to deal with the matter?

Mr. Sandford: The preference is stated, that the split rate of corporation tax should be retained. We can see the problems with integration, so in order to overcome this, integration being accepted as a good principle, the problem of differentiating one dividend from another, we suggest that deferral would accommodate it.

The Acting Chairman: I am glad Senator Molson has raised this point, because in your brief on page 20, particularly the last three lines, your preference is for the retention of the existing rate of taxation on the first $35,000 worth of income.

Senator Molson: Then we come back to your question, Mr. Chairman, that if we do, how do we define the closely held or small corporation?

The Acting Chairman: Exactly. Now, could we again direct ourselves to that question, for our guidance?

Senator Cook: The proposal is for a split rate for all corporations. They just recommend that it be left alone, and in that case it does not matter.

The Acting Chairman: In view of the fact that this association represents so many small business, using that term in an economic or business sense, I would like to get a little closer to what that is by way of definition, in terms of profits and sales. Assuming special treatment for smaller corporations, what should be the guidelines respecting sales and profits?

Mr. Sandford: We felt that we were not competent to make this judgment, because it would take a great deal of analysis, in our opinion, to determine where the dividing line should come. The $100,000 figure was tossed around at our committee meetings as being perhaps earnings up to which the amount would be small, and over which it would not be small, but we felt it was beyond our competence to do a complete analysis of the whole economy to find out where the proper dividing line was. It varies from area to area. What is small in Toronto might be very large in Halifax. We could not see where to draw a line that would be applicable across the whole country, bearing in mind the economic disparities in Canada.

Senator Everett: I am not sure why you wanted to define the small business?

Mr. Sandford: This would be an alternative, if you want a split rate of corporate tax for small businesses, which is recognized by the larger businesses. We surveyed all our members, and can say without exception that the large corporations are not concerned at losing the $10,000, as they would.

Senator Everett: Would you define a small business only in reference to the split rate of tax? Is that correct?

Mr. Sandford: That was our first recommendation, to retain the split rate.

Senator Everett: I understand that.

Mr. Sandford: We realize that there is a problem with our definition, because there is an area here where large businesses do not need this incentive.

Senator Everett: But only for low rate of tax purposes.

Mr. Sandford: That is right.

Mr. Saunders: And for the very important reason, Mr. Chairman, of retaining liquidity in our small corporations because of the unique nature of the construction industry.

The Acting Chairman: Would you direct yourself to page 25 of the brief and read into the record your views with respect to the treatment of capital gains on the assumption that there will be such a tax.

Mr. Saunders: Mr. Stein, would you like to make your comments on that particular question.

Mr. Stein: I will try, Mr. Saunders. I must repeat what Mr. Saunders said in his opening remarks. We expressed our concern last year on the impact of estate taxes and when the White Paper was first released our first statement was our misgivings as to the combined impact and its effect on family firms and on closely held corporations which are predominant in our industry.

I must repeat again what Mr. Saunders said, that the general concensus in our membership is that those fears were fully justified

and that a company, be it a small or a large one—a closely held corporation which, I repeat, is predominant in our industries—would probably not be able to survive this combined impact. This is the essence of our presentation on page 25.

The Acting Chairman: How do you feel on the issue of the capital gains as contemplated by the White Paper being regarded as part of the income as distinguished as being put in a special category with specified rates?

Mr. Stein: We would heartily endorse Mr. Vineberg's feelings of this morning. We believe that it would be unjust and would contribute to the demise of a great many of our companies.

Senator Everett: I have a question on another point, Mr. Chairman.

The Acting Chairman: You have given the answer to my question?

Mr. Stein: Yes.

Senator Everett: We have had so far in our hearings, for the most part, representations from large companies. You are one of the first groups that is predominantly representative of what is termed in the White Paper as closely held corporations.

I would say that a high percentage of the public companies seem to be opposed to the concept of integration. It would appear that they are so opposed because their shares are readily marketable that a holder of shares in a public company, if he is faced with estate taxes or other needs of money can sell his shares on an open exchange. They are concerned that under the 2½ year payouts in the integration provision that they will have to pay out by way of cash or stock dividend all of their earnings each year.

It is understandable that those companies would be opposed to the concept of integration. Can you tell me whether or not, as representatives of closely held corporations, you are opposed or in favour of the concept of integration of the corporate tax or the personal tax of the shareholders to that corporation?

Mr. Saunders: I will ask Mr. Bird to answer that question.

Mr. R. A. Bird, P. Eng., Member, Taxation Committee, Canadian Construction Association: Thank you, Mr. Saunders. Mr. Chairman, I think the members of the construction industry, as Mr. Saunders explained, are all principles of their businesses, whether this be a case of a private firm or a public firm and as such there is not the activity of speculation in private gain on the capital stock of construction firms. Therefore, the interests would identify very closely to the private sector; that is, private and public firms would be pretty well synonymous in their concern in the construction industry.

The aspect of integration therefore would generally be favourable conditionally. This condition is based primarily on the need for working capital which Mr. Saunders has emphasized with the growth and continuity of the firm. In this respect the condition which would have to be placed would be an extension beyond the 2½ year time limit for dividend distribution and the figure of 10 years which has already been mentioned, could pretty well be considered as minimal.

The Acting Chairman: The figure of 10 years is in your brief. No, this has not been outlined in the brief. Mr. Sandford referred to it earlier in our discussions.

Senator Everett: So it would be fair to say that the association generally is in favour of the concept of integration as it applies to closely held corporations, but with an extension of the 2½ year payout requirement to 10 years. Is that correct?

Mr. Bird: That would be correct.

Mr. Sandford: And the allowance for tax referral on the first $50,000.

Senator Everett: We are not discussing that at this point. Having discussed that we moved on to the integration concept.

Mr. Saunders: I want to make it specifically clear that our proposal is that this 2½ year limit be withdrawn and the 10 year period is a compromise suggestion over the bargaining table.

The Acting Chairman: Honourable senators, it might be well to deal with the subject matter of the special treatment of income for your type of company. We have not had much discussion in this committee so far on the aspect of special treatment with the view of computing income in relation to particular types of companies. I think you deal with that on page 33 of the brief.

Senator Burchill: I take it from your recommendation on page 25, Taxation of Capital Gains, that in view of the nature of your

industry and the type of company which you describe and also of the present estate tax that you are not in favour of capital gains. Am I correct?

Mr. Bird: No, I believe that we, like the previous delegation, bowed to the inevitable. The aspect of capital gains, particularly with reference to the need of ownership from father to son is a very traditional method of continuity of the average firm in the construction industry. In fact, the majority of our firms are still operated by the original principals or second or third generations. The capital gains tax which would apply, coupled with the estate tax situation, would produce a condition in many cases where liquidity, which is not generally available within the family holdings themselves, must be raised on the market place. This generally would mean under the new tax situation—the combination of the present estate tax and the new White Paper proposals—a sell-out of the firm. A complete loss of control. That is because of the difficulty, particularly in most private firms, of selling only partial ownership.

Senator Burchill: I fully agree with you, and I just wanted to get that on record.

The Acting Chairman: Coming back to the question of reporting on construction income for tax purposes, which we find on page 33, I notice in your paragraph on the bottom of page 34 that as a result of the careful attention you have given to this matter counsel has been instructed to draft an amendment to deal specifically with the treatment of construction income so-called, and you say that you would be pleased to work with the officials of the departments of finance and justice with a view to implementing the recommendations. Would you be of the view that this committee might be honourably included with the departments of finance and justice, and that it would be in order for us to ask you if a copy of your proposed recommendations could be given to us as a supplement of this brief?

Mr. Sandford: By all means, honourable senator. The point here is that this was a technical change in the act that we thought essential for the construction industry. There are no revenue considerations here. We have counsel working on this and a recommendation has been drafted. We have sent it back for further amendment. We certainly will make it available to you as soon as it is available to us.

The Acting Chairman: When you submit it will we be in a position to regard this document as a further appendix to those already attached to your brief?

Mr. Sandford: Yes, sir.

Senator Everett: I should like to move on to page 38 of the brief, item 11, Valuation of Goodwill. You make the statement in that section that the valuation could result in a retroactive taxation. Not dealing with the suggestion in that section pertaining to the amount of goodwill that should be included in income, could you address yourself to the statement that the valuation itself could result in retroactive taxation and tell this committee how you arrive at that statement?

Mr. Sandford: This was considered by the committee. It is a very difficult area. The draftsmen of the White Paper suggested that, due to the treatment of goodwill as being allowed at 10 per cent, the value of goodwill would increase automatically at the point of I Day, or implementation day. They suggested that a figure of 40 per cent would be appropriate for the increase for the first year. We felt that would be unfair to construction enterprises that had been continuing on for a generation or two. We suggested that with respect to goodwill a 40 per cent increase would be out of line with perhaps the realistic increase of goodwill for that particular company because of the long period of build-up time, that is, goodwill being built up over a generation or two or over a long period of time.

Senator Everett: You are addressing yourself to the operation of the section and the suggestion that is contained therein, but I think what the department is saying is that, by virtue of the fact that they propose to allow a deduction to the purchaser for goodwill, that will increase the goodwill value of the vendor company by 40 per cent. That clearly is not then retroactive taxation. But you refer here to retroactive taxation and I should like you to tell the committee how you arrive at the concept that there is retroactive taxation in the White Paper in this particular context.

Mr. Sandford: It is conceded that, if in fact the value of goodwill did increase by 40 per cent as suggested by the Governement, there would be no retroactive taxation. But we feel in this particular instance that this may be an overstatement of the increase in value of the goodwill and, therefore you would be taxing

goodwill that had been earned prior to the day of implementation. It is a difficult point to argue. I dont think that the Government could defend its 40 per cent position. We could not defend an alternative. We are concerned that in particular instances this could prove onerous.

Senator Everett: Your point is well taken. Could you tell me how goodwill is established under the White Paper? Let us assume that one of your construction companies valued its shares. What portion would it include in the valuation for goodwill? How would it arrive at that figure?

Mr. Sandford: At the value of goodwill?

Mr. Bird: I would say that no operating construction company would value its goodwill. The only occasion when that might occur would be if it was able, through a sale, to achieve a price above its book value. I am talking of course about private companies in that respect.

Senator Everett: Are you saying book value or market value of the underlying assets?

Mr. Bird: That would be primarily the way in which construction companies would be valued on V Day.

Senator Everett: It would be the market value of the underlying assets. Is that right?

Mr. Bird: There really is no other way of achieving this, so far as I can see, in a private company.

Senator Everett: You are saying the value of the shares of a private company at V Day are the aggregate of the market value of the underlying assets. Is that correct?

Mr. Bird: That is correct.

The Acting Chairman: The aggregated net value, I would say, senator, wouldn't you, of a deduction?

Senator Everett: The net market value, yes.

Senator Connolly (Ottawa West): Without a goodwill factor being included.

Senator Everett: What then is goodwill?

Mr. R. MacTavish (C.A., Chairman, Taxation Committee, Canadian Construction Association): If I may interject here, that is not necessarily the way you would value the company at V Day. If it was a construction company with a history of good earnings, it could very well be valued on the basis of "something" times earnings.

Senator Everett: But I am asking you how you value one of your construction companies under the terms of the White Paper. What do you take? Do you take book value, market value, net book value?

The Acting Chairman: Or earnings per share?

Senator Everett: Do you take what a purchaser would pay for the company or provision for goodwill? You have considered this paper and I am asking you whether you know how you would value a company on valuation day. Has anyone in your association been able to determine under the terms of the White Paper how you would value a company?

Senator Beaubien: As high as possible.

Senator Everett: And then don't die.

Mr. Sandford: You might use as a guideline the principles the estate tax authorities used to value for estate tax purposes.

Senator Everett: Let us take that value for estate tax purposes; what portion, then, of that value is goodwill? Have you determined that?

Mr. Sandford: No, we have not.

Mr. Saunders: Mr. Chairman, I think it is fair to say that the committee and the Association have not discussed this point in detail, and it depends upon a fair number of circumstances. If you propose selling your company two days or two weeks or two years after valuation day, then you would place the highest possible value on your company, but if you are concerned with the imposition of estate tax and capital gains tax, then it would be a different consideration.

Senator Everett: It would seem to me, though, that you really are in the same boat as we are because you have no way of knowing how to value a private company under the White Paper.

Mr. Chairman, in that context I wonder if the committee would give consideration to addressing a communication to the Minister of Finance asking him if he would enlighten us on that particular subject by a special paper?

The Acting Chairman: We may get him in a particularly good mood at this particular

time, so possibly this is the right time to send such a letter. However, we have it on the record now and we will await the return of the Chairman and draw it to his attention.

Senator Connolly (Ottawa West): This is only supplementary to one point that Senator Everett made. I think one of the things we might well stress in connection with your organizations and component companies is the very volatile character of your industry. There may be times, and I think this is true, when goodwill has a very high value, when building conditions are good and when there is no surplus and when there is a need for construction, whether the activity be in the public sector or simply in the marketplace. But at other times it seems to me when your industry is in the doldrums, and I think we can all think of specific examples of this, and a construction company could not be sold for love or money, and the goodwill of a company in those circumstances would be practically nil.

Now, is it right to talk about your industry as being an industry that is subject to very serious fluctuations and as being a very risky kind of enterprise? We have heard representations here from petroleum and mining companies about the great risks involved in their particular cases. But it seems to me the construction industry is one which also involves a very considerable risk, though not the same kind of risk as is applicable to the others. Nevertheless, it is a very real risk.

Mr. MacTavish: One particular project I am familiar with that is going on right now is one where a construction company spent $12 million on plant, equipment and camps before they started earning any revenue at all. This was a fixed-price job. They got as high as 7,800 men and the climate went as low as 60 below. The weather conditions were very important and the soil conditions were very important but ultimately this job turned out all right. But there was a tremendous risk factor involved because of the weather, the productivity, labour, recruiting of labour for far northern jobs, transportation and logistics. So it is certainly a high-risk industry.

Senator Connolly (Ottawa West): Does it affect goodwill?

Mr. MacTavish: It sure does. If your company is successful, you look pretty good. But if you hit a bad apple, then you are in trouble for years. If you have a real disaster in a construction company, then you can be in real trouble for years before you can bail out.

Senator Laird: Mr. Chairman, there is one proposal that I cannot remember being discussed in this committee before and it is contained in the brief at page 38. That is a suggestion that there should be provision for advance tax rules, and I would like to point out to whichever one of these gentlemen would like to answer the question that experience in the United States shows two possible difficulties; one, the length of time it takes to get a ruling, and two, if the facts presented hypothetically in asking for the ruling are varied, then the ruling has no validity as far as the Internal Revenue people are concerned. Now, keeping that in mind, do you gentlemen still feel you would like provision for advance tax rulings?

Mr. Sandford: Our comment on this is that it is not peculiar to the construction industry. It was brought to our attention at various meetings that one of the main concerns on any business deal are the tax implications, and we, I feel, are not the group to ask as to the merits or demerits of these various pros and cons. We do feel that there should be some expression in advance by the taxing authority in the form of a ruling or, perhaps, more specifically general guidelines. There should be some way that the taxpayer who is involved will have a pretty fair idea of the tax results of the various alternatives available to him at a particular time.

Senator Laird: Well, really what you are saying now is that you would like some sort of unofficial opinion, is it not?

Mr. Sandford: That would probably be better than nothing. Some unique arrangements arise in our industry and in other industries and we realize that this would take a lot of input by the taxing authority, and we think there should be some cost involved to dissuade frivolous requests. But if you are genuinely concerned and want to have something, there should be some way of obtaining advance information.

Senator Laird: But at the present time, if you indicate that you are going to be satisfied with some unofficial ruling, the present state of the law is such that the department is never bound by what one of its members states, and some of us who are lawyers have found that out the hard way.

Mr. Sandford: That is right, and perhaps the question would have been better put to Mr. Vineberg when he was here. We feel that

maybe there is an area here that should be investigated by somebody.

Senator Laird: You would like to explore the possibility without being dogmatic?

Mr. Sandford: Yes.

The Acting Chairman: Mr. Saunders, I think you wished to augment a point.

Mr. Saunders: Yes, Mr. Chairman. Getting back to the item of goodwill, I think the question we should ask ourselves is "when do you want to use goodwill?" Because in the day-to-day operation of our business, and I am speaking now of the contracting segment of the industry, goodwill in lump sum contracting usually has very little value, because awards are made on the basis of the low tender, and when dollars and cents are involved, the buyers of construction usually do not consider goodwill as a very large asset. On the other hand, if we are tendering in an area where there is an invitational type of tender called, goodwill has some merit as far as the industry is concerned.

The Acting Chairman: What do you mean by "an invitational type of tender"?

Mr. Saunders: Very many buyers of construction, Mr. Chairman, invite a select group of companies to bid on the project, and this is an invitational tender.

Senator Connolly (Ottawa West): This industry is run through, as you have said, with prime examples of small business, family businesses; and you argue—I think, quite soundly—for the perpetuation of the favourable rate of tax for the so-called small or family business. In your own experience, has this lower rate of tax for small business led to the development of small business into bigger business, or of the development of smaller companies into larger companies?

Mr. Saunders: Mr. Stein will answer that question.

Mr. Stein: Senator Connolly, most definitely, yes.

Before I go on, I would like to compliment you on your appreciation of the construction industry and say that I wish that a great many others in Government had your knowledge of it. It certainly is a high-risk industry.

As for your question, the answer I would say is: Most definitely, yes. And this accompanies logically the technological developments in our industry. As new techniques and as new products are brought on to the market, we find we develop specialists, particularly for the installation of these new products.

I do not want to pick on any one, but let me take one merely as an example—I am not pleading a cause for it—and this is known as dry wall construction. That is steel studs and gypsum boards which, to a large extent, have replaced wood studs and plaster or masonery partitions and plaster. This is a comparatively recent development, and there has now developed a breed of dry wall applicators, a trade which never existed before; and, by the same token, we have developed a group of subcontractors who specialize in dry wall applicators, who started as a one-man show and now have developed into sizeable companies which specialize in dry wall and acoustic applications. This is but one example. The dry wall and the acoustic applications go together—acoustic applications for ceilings and dry wall for plaster. We find that, whereas once upon a time acoustic installation was a branch of a large manufacturing company, they now do nothing more than produce the materials, and the dry wall applicators have absorbed that, so this has become a business and there are some fairly substantial companies now who specialize in this.

Senator Connolly: And there is a big spillover too?

Mr. Stein: Yes. This is part of the natural growth of specialty subcontracting accompanying technological developments and, by the same token, this is one of the factors which is keeping construction costs under control.

The Acting Chairman: That is very interesting, think.

Senator Connolly (Ottawa West): I want to make one observation, and say nothing about the compliment the gentleman paid me, for the simple reason I want to be able to use this with my wife, who does not think I can even drive a nail.

The Acting Chairman: We will arrange, at Crown expense, for a transcript of that part of the evidence!

Senator Connolly (Ottawa West): But not my comment now.

The Acting Chairman: No.

Mr. Saunders: With your permission, Mr. Chairman, I would like to elaborate on the question raised by Senator Connolly. You see

before you today representatives of four general contracting firms which were initially family-held firms. My particular firm, Mr. Stein's firm and Mr. Bird's firm are still family-controlled construction companies that started on a very small basis and now are multi-million-dollar construction firms. This gives some testimony to what is happening within our industry.

Senator Connolly (Ottawa West): In other words, in your own experience, and perhaps within your own memory or at least your father's memory, the change that has been made by the tax authorities, in progressively benefiting small companies by reducing the level at which the tax should be paid, indicates that in the past, at least, there was a better appreciation of the importance of encouraging the small company so that it could become a large company.

The Acting Chairman: Honourable senators, I would like to ask you to be good enough to turn to page 35 of the brief, dealing with the subject matter of consolidated returns. The reason I ask you to do that is that this association is one of the few representing taxpayers that has come before us in support of the suggestion that we do have consolidated tax returns.

I think you will remember that I personally was strongly in favour of this, and I would at least like reference in the record to indicate that this association is supporting the conception that we revert to the right of consolidated tax returns, as appears on page 35 of this brief.

Mr. Saunders: Thank you, Mr. Chairman. I will ask Mr. MacTavish to comment on that particular point.

Mr. MacTavish: Honourable senators, in the construction industry there are many associated companies that spring up sometimes because of geography. They might want to incorporate a Newfoundland construction company, with a Quebec construction company, and so forth. Sometimes some of these operations are successful and profitable, whereas another one may not be. Under the existing law you might obtain tax relief in one corporation but not be allowed to write off losses in another corporation. I am quite sure sometimes this leads to lots of manipulation, putting contracts through one company instead of another, and so forth.

We feel it would simplify the tax return, from the department's point of view, if we were allowed to consolidate our returns. I can think of one situation where one chap lost quite a bit of money, but still wound up paying taxes in that particular year.

The Acting Chairman: I suppose you would agree, if there was consolidation, that a penalty should be applied on a certain percentage, as was the law in the old days, for that privilege—say, 2 per cent, or something of that nature?

Mr. MacTavish: Yes.

The Acting Chairman: I understand that Mr. Bird would like to supplement his prior observations.

Mr. Bird: Yes, thank you, Mr. Chairman. Really it is with respect to Senator Connolly's question about the split rate benefits to the smaller construction companies and allowing them to grow and expand. I refer to pages 21 and 22 of the brief, in which there is a fair amount of detail outlining the way in which construction companies are able to secure performance bonds in order to be able to carry on a volume of construction which is directly related to the retained working capital in the firm and is generally in a ratio of 1 to 10. It must have sufficient working capital to underwrite the volume of incomplete work under contract of 10 per cent. This means that under the present split rate system a firm was able to retain the $10,000 in additional profits, and this would have an impact of an increased volume of business in the ensuing year of $100,000. The figure shown on page 22 is $125,000, and that, of course, refers to the proposal of the deferred tax of $12,500.

Senator Connolly (Ottawa West): I have a question that does not really relate to the White Paper, but it does relate to the general philosophy that should be guiding us when we consider taxation in respect of this particular industry.

As honourable senators know, I had the occasion to visit Russia in January. They are making great strides over there in the development of their north. Nothing comparable has happened in this country. They have great cities built on the permafrost, and they are cities of 100,000 and 150,000. It seems to me that there is a tremendous challenge to the construction industry in this country if that frontier is to be opened up and made livable. I think that this has an application to the proposals in the White Paper, and it would be interesting to hear from you whether you feel the Canadian construction indus-

try is going to accept that challenge and whether it will be able to deal with the conditions that obtain in those colder parts of our country and in those less accessible parts of our country.

Mr. Saunders: I will ask Mr. Stein to answer that question.

Mr. Stein: Thank you, Mr. Saunders. I am delighted that you have asked that question, Senator Connolly.

In the first place, the construction industry has accepted, and successfully met, every challenge that has been put to it, and here I am thinking of the St. Lawrence Seaway, the Expo site in the middle of a river that was built in three and a half years when the predicted time of construction was seven years, Manicouagan, Churchill Falls, and Kettle Rapids. We have proven that fact time and time again.

I had the pleasure last year of being up in Whitehorse when the CCA presidential party visited our affiliates, and I have seen our construction companies in action.

We have developed techniques of wintertime construction equalled by nobody else in the world. In fact, I had the personal pleasure of meeting with a delegation of Russian technicians—a member of the Council of Ministers and his entourage—who were interested in northern construction on the permafrost, and in precaste and prestressed concrete structures which are very useful in the north. They came to Canada to see how we are doing things.

We have been invited by Senate committees in the United States to go down there, and tell them how we have been carrying out our winter construction.

Fifty years ago nobody would dream of building a reinforced concrete structure during the winter, but today that method is taken as a matter of course.

Mr. Saunders: Mr. Chairman, I should like to supplement Mr. Stein's remarks by saying that we have a committee within the organization of the Canadian Construction Association that devotes itself solely to wintertime construction.

Mr. Stein: And it collaborates with the division of building materials of the National Research Council.

Mr. S. D. C. Chutter, General Manager, Canadian Construction Association: There is one aspect of Senator Connolly's question that ties into the proposals in the White Paper. A great deal of construction is being carried out in Canada's north, and this does entail extra risks for both the investor and the contractor in question. This all the more bears out the necessity for these factors to be considered in the formulation of tax policy. That relates, I suspect, to half of our recommendations in our brief in one way or another.

Senator Connolly (Ottawa West): It is very heartening to every member of this committee to hear that, and I think it should be taken into account by the people who write whatever legislation may follow from the White Paper. What you say seems to be borne out from my own experience. I remember as a young boy that people who worked in the construction industry were automatically laid off in December, and were not hired again until April or May. We now see buildings going up all through the year.

The Acting Chairman: I think you have in mind that, in a sense, because of these peculiar factors, this industry should be assimilated to natural resource industries which are given special incentive or, at least, special consideration.

Senator Connolly (Ottawa West): It is hard to pinpoint. But, Mr. Chairman, it does seem to be an industry in which there is an element of very high risk, and I think it is important that have that fact on the record.

The Acting Chairman: There seem to be no further questions, so thank you, Mr. Saunders, for your submission.

Mr. Saunders: Thank you very much, Mr. Chairman.

The Acting Chairman: We shall hear now from Markborough Properties Limited, who are represented by Mr. B. R. Magee, Mr. D. F. Prowse, and Mr. R. D. Brown. I understand that Mr. Magee will commence by giving a general summary of the brief.

Mr. B. R. Magee, President, Markborough Properties Limited: Thank you, Mr. Chairman. Can you tell me how pressed you are for time. I know that you are running a little late.

The Acting Chairman: We usually endeavour to adjourn at about 12.30, and perhaps this is an opportune time at which to discuss this matter. We have two further submissions to hear, one from Budd Automotive Company of Canada Limited and the other

from Conwest Exploration Company Limited. I am wondering how the members of the committee feel towards my suggestion that at 12.30 we adjourn until 2.15 at which time we will consider those two briefs. It is obviously not possible to deal with them this morning.

Senator Connolly (Ottawa West): I have to attend another meeting at 2 o'clock, Mr. Chairman.

The Acting Chairman: We have at least had the advantage of your presence here this morning. Is it agreed that we reconvene at 2.15 this afternoon to consider the two remaining briefs?

Senator Beaubien: Yes, because the Senate sits at 2 o'clock.

Hon. Senators: Agreed.

The Chairman: The gentlemen who are waiting are welcome to remain, but if they leave they should return at 2.15. Mr. Magee, you have until 12.30, but the law of the Medes and Persians will not apply if you find you need a few more minutes.

Mr. Magee: Thank you very much, Mr. Chairman. I am glad to have these ground rules because many years ago I was told that I should get out while people still wanted to listen to me. I shall try to make my remarks as brief as possible.

I should like to thank you for the opportunity of appearing before your committee. I plan to describe briefly our company, and then to summarize the contents of our submission.

Markborough Properties Limited was formed in 1965 to engage in all aspects of the real property industry. Our operations concentrate more particularly on the development and holding of income-producing properties and on the development and sale of land for residential, commercial and industrial purposes. A substantial number of our properties are located in the Metropolitan Toronto area, but we also have land for development in Montreal, Winnipeg and Vancouver. We have, in addition, a 50 per cent joint venture interest in a hotel and commercial complex in Regina.

I should like to refer back, Mr. Chairman, to your consolidated return, because it has a very important effect on our company, and other companies. Our major current development project is a 75,000 person community to be located on 3,000 acres of land on the outskirts of metropolitan Toronto in the towns of Mississauga and Streetsville.

With due respect to any honourable senator from Prince Edward Island, we will have more than half the population of Prince Edward Island when we get through.

The development of Meadowvale has been in the planning stage for three years and will be done on a completely integrated basis; that is, it will provide a full range of residential accommodation together with commercial and industrial areas, in short a complete city. The total investment in land, services and construction, when completed, is estimated at over $600 million.

At the present time the company's assets total about $60 million. While this figure is modest compared to some other companies in the industry, it does represent a continued and satisfactory growth in the four and a half years since the company's inception.

The company's shares are listed on the Toronto and Montreal Stock Exchanges and are held by some 2,400 shareholders, over 90 per cent of whom are Canadians. This includes some 25 Canadian corporations, pension and mutual funds.

In our submission, we have pointed out the real property industry is a "capital intensive" industry requiring large amounts of money for long periods of time. We have indicated that in our view, the consequences to the real property industry of implementing the tax reform proposals in their present form would be to further reduce the amount of capital available for servicing land and building residential and commercial buildings. We feel that the proposals will restrict the accumulation of private capital and development which, perhaps slightly prejudiced, we feel is more efficient than public development and cause a shift in the utilization of capital available from bonds, mortages and equities in growth companies to mature equities.

Because of our company's ownership interest in a hotel in western Canada, and our concern in the possibility of increasing this area of our operations, we are concerned about the impact on the hotel industry of the proposal to disallow for tax purposes, outlays on convention and entertainment expenses.

I think Mr. Vineberg in his chat with you has given some excellent examples of why such allowances are necessary.

Apart from the loss of business which we expect will be suffered by the hotel industry,

with resulting economic losses to owners and operating personnel, we are convinced there will also be a significant social loss. Convention travel within the country serves, among other things, to acquaint travellers with the regional problems and differences that characterize Canada. The loss of this first hand knowledge and experience among businessmen would be regrettable.

Rather than inhibiting the flow of capital into the real property industry, we feel that the Government's tax reform proposals should contain incentives to stimulate the flow of such capital. Two suggested techniques might be considered: (a) a recognition by tax authorities, as a charge against taxable income, the erosion of one's investment in debt securities through inflation.

I need hardly mention what inflation has done to our Canadian Government bonds.

The Consumer Price Index, published by the Dominion Bureau of Statistics, might be used to measure this loss. (b) The provision for real estate investment trusts similar to those provided for in the United States. These trusts are exempt from tax on income distributions to shareholders if the real property assets and income represent a specific percentage of the total.

In short, under the Real Estate Investment Trust Act in the United States, provided 90 per cent of the income is distributed to the unit participants, then it flows through that vehicle tax free but, of course, is taxable in the individual hands.

To enable home owners to meet the current high cost of money we have also suggested that consideration be given to allowing mortgage interest as a deduction against one's personal income for tax purposes.

Throughout the White Paper the honourable Minister of Finance and his colleagues seem to have developed a phobia on loopholes. I think in the majority of cases these are a very small minority of the problem.

I would like to read into the record section 55 at page 32 of the brief submitted by the Canadian Association of Real Estate Boards, in the preparation of which I assisted on the committee. The section is in connection with loopholes and I think is well drafted:

> The very categorization of "loophole" represents a value judgment in itself. The Department of Regional Economic Expansion set up by the Government of Canada would look quite different to the public if it was labelled as the Department of Creation of Selected "Loopholes". Measures for stimulating growth in designated areas, steps to encourage scientific research, special stimuli to the shipping industry are all "loopholes" in this sense. So is the entire capital cost allowance system. If it has led individuals to increased savings and investments so much the better.

We believe that certain of the Government's proposals for tax reform would have damaging effects on the full development potential of the country by dangerously reducing the amount of capital available for the servicing of land and the construction of new housing and commercial buildings. The development of adequate housing and other construction is vital to the economy of the country and the well-being of the Canadian people.

One of the overall effects of the proposals would be to restrict the accumulation of investment capital and to cause a substantial shift in the flow of that capital from bonds and mortgages to mature equities. The Government itself states that "some moderate reduction in aggregate private savings" would occur.

I think the figure mentioned at the end of five years was $525 million.

Whether the reduction will indeed be "moderate" remains to be seen; what the Government does not mention is that a more important consequence is likely to be a not so moderate effect on the bond and mortgage markets, and on the supply of housing and other buildings.

In short, those funds will probably be redistributed among the consumers and spent on consumer products, rather than on expenditures of a more capital nature. We are in a housing crisis. I think that is well recognized, but the White Paper will in our opinion only accentuate the situation.

The shortage of mortgage capital is already placing severe stresses on the real estate industry. Money is in great demand and short supply; interest rates and housing costs are skyrocketing. (The average cost of a new house in metropolitan Toronto is about $42,000 now compared with about $21,000 in 1965.) Inflation is discouraging potential investors of mortgage capital, and this in turn

is discouraging potential investors of real estate development risk capital.

Again, later on in the brief, gentlemen, we will see that we have the same problem as the construction industry, that for every dollar of equity we are probably looking at five or six dollars of debt. Last year, apartment construction in Metropolitan Toronto dropped over 10,000 units, which represented a drop of about $125 million in construction alone.

The Acting Chairman: Are you making the point that the diversion of the $600 million to government rather than it being in the private sector would form the base for equity for expansion in the economy at large?

Mr. Magee: It could be at the moment, sir.

It is in this setting that the government now proposes to introduce tax measures which would discriminate directly against the real estate industry. Companies in that industry would effectively be prohibited from deducting full capital cost allowances on the same basis as companies in other industries; in many cases they would be denied deductions for interest and realty taxes, which are necessary and legitimate business expenses.

The Government's proposals concerning capital cost allowances and interest in realty taxes, if implemented, can only further discourage equity investment in real estate development and lead to an even more serious decline in new residential construction. No explanation is offered as to why these sharply restrictive and complex rules should apply only to the real estate industry, and why this industry should be singled out for adverse treatment, particularly when we have a current and growing housing crisis in this country.

At this point, Mr. Chairman, I can stop and entertain any questions that any of your colleagues may have, in the interests of time.

The Acting Chairman: I am sure honourable senators would like to give the floor to Senator Connolly (Ottawa West) before he leaves, if there are any questions he would like to put.

Senator Connolly (Ottawa West): I think other honourable senators might have questions, and I will let them go ahead, although I thank you, Mr. Chairman. I think I have taken up a lot of time already.

The Acting Chairman: I am very serious on that point, in view of the fact you have to leave. We thought you might want to put some questions.

Senator Connolly (Ottawa West): I will be very brief then. Do you think the private sector is able, willing and anxious to cope with the shortage of housing that seems to persist in Canada today, rather than dealing with it through the facilities afforded by such agencies as Central Mortgage and Housing?

Mr. Magee: Yes, I think the private sector can, if it is not continually being turned on and off by the government on whether there are mortgage funds available or not. I think Mr. Hignett and his college of Central Mortgage and Housing would be the first to admit that the private sector of the country can produce houses more efficiently and economically than can be done through C.M.H.C. or any other municipal offices. I think that has been proven when you look at slum clearances, urban renewal projects and the cost of houses. I suppose the most outstanding example has been the Ontario Housing Corporation, with their building proposals, rather than going through the recognized method of subsidized housing, or putting it out to tender.

I think the record shows that the Ontario Housing Corporation has done a remarkably good job, and a far more efficient job by saying, "We are not going to say what you are to build. We know what we want in general terms. You come in with a proposal within those guidelines and an end selling price. Never mind hiring a lot of expensive architects and all the general mechanical trades and everything. We want a package proposal that you will deliver a building for a sum of money", and invariably it is considerably lower than the old-fashioned route of putting things up, getting plans that are fixed and putting them out to tender.

Senator Connolly (Ottawa West): I suppose, though, you would recognize the importance of institutions like C.M.H.C., the Ontario organizations and other comparable organizations in the provinces. Sometimes social requirements call for the development of housing units and housing areas, that normally the private sector would not initiate and, even though it is initiated by public funds, would not necessarily want to participate in.

Mr. Magee: I think you can go back to the limited dividend policy that 10 or 15 years ago was reasonably effective. Then unfortunately the terms and attraction of those

investments did not keep up with the current construction market and it fell into disfavour. Recently there have been one or two cases where they have endeavoured to get it going. I think Central Mortgage and Housing performs a very valuable function. It is probably the most profitable crown corporation we have ever had, if you have ever looked at its balance sheet. Any money from public funds lent to C.M.H.C. has done extremely well over the years, as well as providing a very important social need.

Senator Connolly (Ottawa West): Would you agree that they have led the way in an area where there had to be important, expensive and extensive initiatives taken, say since 1945, since the end of the war?

Mr. Magee: Yes, I think they have taken a lead, but in relation to their overall portfolio, what they have spent on their experimental work has been minute.

Senator Connolly (Ottawa West): On their experimental work?

Mr. Magee: New housing types, new schemes, new scholarships, bursaries, special studies that they have performed.

Senator Connolly (Ottawa West): Do you think that is very valuable?

Mr. Magee: I think it is an important adjunct, yes.

Senator Connolly (Ottawa West): Has it stimulated the private sector to help in that area of development?

Mr. Magee: I think of Expo and what went on on the waterfront there, and I do not think that experiment stimulated too much new construction. The Russians are getting into prefabrication, new housing modules, new housing units. All of this is coming. There is the question of the Canadian Construction Association and the work on prestressed concrete, where tremendous advances have been made. But tremendous advances have been made by the private sector as well as the public sector.

Senator Connolly (Ottawa West): What proportion of development is private as opposed to public, in housing?

Mr. Magee: I cannot give an accurate figure, other than that I know in Metropolitan Toronto—again with due respect to the minister when he talks about the doctors, and the lawyers receiving a tax shelter—57 per cent of all the rental accommodation is owned by private individuals.

Senator Connolly (Ottawa West): That is quite a good answer.

Senator Molson: I would like to refer to page 1 of the brief, the last paragraph under B, the summary of the submission, where it states:

> The average cost of a new house in Metropolitan Toronto was about $42,000 in 1969 compared with about $21,000 in 1965.

It mentions there the shortage of mortgage capital and the short supply of money. I would like to ask Mr. Magee what impact the wage settlement had in Toronto a year ago on the rest of these costs and in the figures such as that. The settlement, as I remember it, was an extremely rich one and covered the whole construction industry. Is that correct?

Mr. Magee: No, not really, Senator Molson. I think we may be talking about two things. We are talking about union and non-union. There is still quite a large amount of residential construction being built in the metropolitan Toronto area by non-union labour.

To answer your question, the residential costs have probably been averaging between 8 and 10 per cent per annum for the last three years.

Senator Molson: How much of that is labour costs?

Mr. Magee: I would guess if you take direct and indirect labour, that is off-site as well as on-site, you are probably running about 75 per cent of your total costs. Perhaps Mr. Stein would confirm those figures.

Mr. Stein: Is it in order, Mr. Chairman?

The Acting Chairman: Yes, the suggestion is that the direct and indirect cost in respect to construction would go up to 75 per cent.

Mr. Stein: Not on on-site labour, sir. Direct on-site labour has dropped from about 40 per cent. I am talking about housing construction. In such instances it has gone as low as 25 per cent.

Mr. Magee: I was meaning on-site and off-site labour which makes your furnaces and all of the rest of it. The labour content in the total house would be considerably higher.

Mr. Stein: We have used as the rule of thumb that for every dollar spent on-site or

rather for every employee on the site there is an employee in the manufacturing plants somewhere producing the goods or the components.

The Acting Chairman: An amount equal to every dollar spent on site.

Mr. Stein: Or every person employed on the construction site. At least one person is employed in manufacturing for the construction industry.

The Acting Chairman: It is at least 50 per cent if not up to 75 per cent.

Senator Cook: In this figure you include the cost of land?

Mr. Magee: Yes sir.

Senator Cook: Has it increased for that period, the cost of service lands?

Mr. Magee: It has gone up very drastically. It has also gone up drastically if you recognize the demands for the various municipalities for the services. The cost of servicing lands in metropolitan Toronto is running in excess of $20,000 an acre and getting probably four individual houses to an acre.

Senator Cook: The raw land has also increased sharply?

Mr. Magee: The raw land is up from last year, but it has now gone down considerably. Apartment suite land was selling at $3500 a suite before the White Paper, but now it is probably selling at $2500 a suite. We sell apartment house land at so much per suite.

Senator Beaubien: How big is a suite?

Mr. Magee: A suite will run between 800 and 1200 square feet net useable and net useable is probably 80 per cent of the gross.

Senator Aseltine: How are you going to arrive at the value of your properties on valuation day? Do you do that yourself or does the Government?

Mr. Magee: With due respect of the Minister, we are not going to ask our neighbours, sir. I think Mr. Vineberg from the Canadian Association covered the question of homes in respect of the evaluation of property.

In the interest of time I would not go into that. When you get into an industrial or commercial or income producing building you have books and you have the three methods of valuation; coming to a market valuation of the cost of the building originally, the income approach and the comparable value which you go to your neighbour for.

Senator Aseltine: You say the valuation of your real property is way down at the present time to what it was a year or so ago.

Mr. Magee: I would say generally speaking that everything is peaked out. I would like to say a few words about the rental market, particularly in residential apartments and town houses in relation to the increased cost of mortgages. I could give you a few rules of thumb which might be significant. Three years ago the N.H.A. rate was $6\frac{3}{4}$ per cent. Today the N.H.A. rate is $10\frac{1}{2}$ per cent. If you take an apartment building with a mortgage of $12,000—and this is not unrealistic—per suite, one percent of that is $120 and one-twelfth of that is $10. With the increased cost of money going from $10\frac{3}{4}$ to $10\frac{1}{2}$ you have nearly a 4 per cent jump. That is causing an increase in rents of nearly $40 a month for the average apartment.

Senator Beaubien: Forty dollars. That is forty dollars based on what it would have cost $75 a month before?

Mr. Magee: A builder starting three years ago and a builder starting today is faced with having to receive another $40 a month for the same accommodation, forgetting completely about the increase of probably 25 per cent of construction costs.

The Acting Chairman: I believe Senator Beaubien wants to know what is the $40 superimposed.

Mr. Magee: That would be imposed, sir, on probably a rental of $150 and $200 a month.

The other thing about capital cost allowance which I think is very significant is that if capital cost allowance cannot be an umbrella and a shield for causing buildings to be built, apartment buildings in the major metropolitan areas will probably receive, after operating expenses, municipal taxes and principal interest, a return on equity of about 5 to 7 per cent. That is uneconomical when you consider a mortgage rate of 10 or $10\frac{1}{2}$ per cent. If the capital cost allowance umbrella is removed through the White Paper then you are going to find those investors, who were happy because of the capital cost allowance, taking a 6 per cent return on their equity. They will want a more realistic one, perhaps 12 per cent which is not unreasonable, being one or two points above the current first mortgage rate.

To give you a very simple example, gentlemen, if an apartment building were generating a gross income of $500,000, and after operating expenses and payment of mortgage, principal and interest, there was $50,000 left, that would represent about a 6 per cent yield. If the capital cost umbrella is removed, that investment would want double that $50,000 to bring its return up to 12 per cent.

Senator Everett: May I just interject, Mr. Magee? That 5 per cent or 6 per cent or 7 per cent yield that you talk of I assume is in the first year.

Mr. Magee: No, that is a continuing investment, sir. He is putting in "X" thousands of dollars of equity over and above the mortgage and he is expecting a return on that investment.

Senator Everett: But as he pays off his mortgage, wouldn't his equity increase?

Mr. Magee: Yes, but then you have the question of depreciation and usually it is assumed in the business that your depreciation and principal payments more or less balance each other out over the term of the mortgage, if it is a 30- or 35-year mortgage.

Senator Everett: So you don't think there would be an increase in his equity, then?

Mr. Magee: On the long-term, yes, but on the short-term and in the foreseeable future, not to any great extent, no.

Senator Everett: Taking it over the last few years and not taking into account the inflation in rents, what would the 5 per cent equity have been over the life of the mortgage? What are you talking about? Twenty-five-year mortgages?

Mr. Magee: Twenty or thirty-year mortgages, yes.

Senator Everett: What has the experience been? If you ignore the increase in rentals received and you start, say, 20 years ago or 25 years ago with a 5 per cent return, what would that return have averaged over the 25 years? I ask that because depreciation really has been off-set against taxes, hasn't it, in the last 25 years?

Mr. Magee: I would say that an existing building today compared to an existing building five years ago would give a lower return. The return on the same building five years ago would have been greater than it is today. You have additional burdens today. Right now the municipal property taxes are running, again in the Toronto area, between 22 and 25 per cent of the gross income. The people are paying $525 a suite when the total rent is about $2,000.

To come back to my example, if you will go along with the idea that he will get a reasonable return with no capital cost allowance, he will have to have 12 per cent and another $50,000. That means that that will add another 10 per cent to the rents that he has to get.

Senator Everett: Are you saying he has no capital cost allowance?

Mr. Magee: I say if the umbrella is removed. There are certain provisions in the White Paper that restrict it to one building. There is no longer the blending of a number of them.

Senator Everett: He has capital cost allowance even under the White Paper.

Mr. Magee: There are certain ominous overtones; the minister thinks those terms are too generous. My contention is that they are not generous enough with all the other circumstances we find ourselves in.

Senator Everett: Are we not referring to two different things? One is the concern with the minister's statement that the capital cost allowance will have to be reviewed, but, indeed, even in that case it is presumed that there will be a continuing capital cost allowance. The other is the fact that the capital cost allowance will be confined to the income from the particular building on which it is taken.

Mr. Magee: On point one I would say that, if the capital cost allowance is changed—and the reason I am bringing this up is as a warning or a suggested warning—if it is changed, it is only going to do one thing; it is going to increase rents right across this country.

Senator Everett: But, in your example, if depreciation equals the increase in equity, then why does it matter?

Mr. Magee: Would you like to handle that one, Mr. Prowse?

Mr. D. F. Prowse (Vice-President, Finance, Markborough Properties Limited): I am not sure I understand your question, senator.

Senator Everett: I understood Mr. Magee to say that if an investor started with a $500,000

equity investment and received a return --which I gather is average in the metropolitan areas—of $50,000, he would be getting a 5 per cent return on his equity. I was asking Mr. Magee what happened to that percentage return on equity as the investor paid off the debt. Presumably the return on his equity increases.

Mr. Prowse: Yes.

Senator Everett: Mr. Magee's answer was that that was correct but that it is off-set by depreciation so that the whole thing averages out equally and the man has 5 per cent all the way through the life of the mortgage. I would have thought that in those terms depreciation would have been a relief from taxes, and Mr. Magee subsequently suggested that it would be, and therefore the investor's return would in fact increase over the life of the mortgage, in terms of a 20- or 25-year mortgage. At least I would have thought it would.

Mr. Prowse: Perhaps it would help clarify the situation if I were to give you the method by which the industry calculates the yields on buildings, which is really what we are talking about. The yield is really composed of two things: it is composed of the net cash flow as a percentage of the equity in the building during the period of ownership of the building; and it is composed also of another figure, which represents the value of the building at the time the building is disposed of, over the owner's equity in the building at that time.

To the extent that the building has appreciated at that point, that appreciation can be worked back over the period by application of tables to see how much the annual yield has been increased so that the real annual yield is the addition of those two figures.

It is true, I think, that in the past, appreciation on buildings when they were sold served to augment annual yields. At the present time, with the annual yield being somewhat in the neighbourhood of 6 per cent, it is highly doubtful if buildings can be sold at rates which will show appreciation when worked backed over the years. The yeilds are simply too low.

If I might take a minute to illustrate with a specific building that we own, it might put this problem into focus for the senators, Mr. Chairman. These figures are on a per suite basis, which is the easiest way for us to calculate them.

In this particular building the construction cost was $13,400 per suite; the land cost $3,000. The total cost for this building per suite was $16,400. It was erected in 1968 and the mortgage on the building was $6\frac{3}{4}$ per cent for 30 years. The mortgage rate was $12,300. So we had an equity in each suite of something like $4,100. Taking the average income of this particular building in 1969, the average per suite income, the annual rent per suite was $2,200. The total of the operating costs and realty taxes and debt service was $1,930. So that we had a cash flow after debt service of some $270.

This figure, as a percentage over investment of our equity investment of $4,100, was a return of 6.58 per cent. That is before taxes and before an overhead allocation.

Under the existing system of capital cost allowance, in the first year the capital cost allowance applicable to this building on a per suite basis would be $670, that is 5 per cent of the cost of the building portion. So, for tax purposes, the profit on a per suite basis for that building was $270 cash flow, and if we add back the principal payment on the mortgage which is not an allowable deduction for tax purposes, we get a profit projected of some $390, but we have a capital cost allowance.

Senator Everett: Would you mind going back over that for a moment again, please?

Mr. Prowse: Yes, the cash flow from that building was $270, and that included the payment on the mortgage and we added that back. That is $120.

Senator Everett: So that is $390 altogether.

Mr. Prowse: Yes.

Senator Everett: That is the increase in your equity at that point.

Mr. Prowse: And so we get a profit for tax purposes before capital cost allowances of $390. Now under the balance method, we have a capital cost allowance of $670 that is available, and we use $390 to offset the income from the building and we carry forward the $280 to apply to other income in our business. Now the application of that $280 enables us to save tax of $140 in round figures with 50 per cent. Now if the White Paper proposals are implemented by which we will not be able to carry forward that $280 excess capital cost allowance, it means that our $140 tax saving is lost.

Senator Everett: You are not talking about carrying it forward, you are talking about carrying it sideways.

Mr. Prowse: Right.

Senator Everett: Under the White Paper you will still be allowed to carry it forward by not taking the...

Mr. Prowse: Yes, I used the wrong term. I meant extending it to other income. Now the point is that there is a cost to the company in terms of lost savings of $140 which has to be derived from somewhere, and in order to produce $140 in cash, we have to increase revenue by $280 because on the White Paper basis, half of it will be taken by tax. That means that on a suite based on this particular building, if we cannot carry out capital cost allowance sideways, we would be forced to increase the rent on the building by $280 a year or something over $20 a month.

Senator Cook: Would that have any effect on municipal tax?

Mr. Prowse: No, it wouldn't. May I just go on for one moment to put into focus the additional ramifications of the interest and realty taxes proposed in the White Paper. If we take the same building, which is an actual case, and eliminate the mortgage financing that was placed in 1968 and superimpose on the results the mortgage financing that would exist if we did it today, which would be something like $10\frac{1}{2}$ per cent for 35 years, the cash flow that the building actually throws off, which is some $270, would be reduced to a cash loss, before any capital cost allowances, of some $78. This is due exclusively to the fact that the interest charge, instead of being some $830 as it was before, is close to $1,300 because of the increased interest rates.

The Acting Chairman: And not offset by increased revenue?

Mr. Prowse: No, I am saying only if this building with existing revenue is changed only by financing.

Senator Everett: You would be at a loss?

Mr. Prowse: It would be a cash loss.

Senator Everett: Let me ask this question, then; that is the return on equity in 1970 taking into account the fact that you have a six and three quarter per cent mortgage?

Mr. Prowse: You are earning approximately the same as in 1969.

Senator Everett: 6.5?

Mr. Prowse: 6.5.

Senator Everett: So you are taking a cash flow of $270, but you have an increase in your equity and you pay off your equity to the tune of $120 in two years.

Mr. Magee: Senator, the normal established rule in our industry is that we take principle and interest and that is the return on the thing. Now it will be slightly increased, but in your early years, as you know, on a 30-year mortgage the amount of principle that you pay off is minute.

Mr. R. D. Brown, Auditor, Markborough Properties Limited: I think there is some confusion in the measuring of yields. The real estate industry not only measures it on a cash flow basis, and as most mortgages are arranged so that there is equal payments every year of blended interest and principle, the cash flow does not change over the initial period, and therefore the return calculated on the basis of cash flow would not change.

Senator Everett: That's right on the basis of cash flow. But I was concerned about the return on equity which is something different. I agree with Mr. Magee that in the early years the change is minute, but carrying on on that point, you say on page 8 of your brief "we are not unaterably opposed to the government's proposal"—that is to classify the buildings as a $50,000 building. Now you exempt from that real estate companies, and companies whose main business is real estate, and you say that the $50,000 limitation should be increased. In light of what you say here, and in light of the point that Mr. Vineberg raised whereby he sees that people or companies who are not solely in the real estate business might be able to use losses as a means of reducing their income, would you not like to amend that point in your brief, that they remove the classification?

Mr. Prowse: Senator, we took that position because it is not really our business to buy and sell buildings. In our company we are attempting to build a portfolio of income properties, and we really are not in the business of buying and selling buildings to make a profit, but rather holding properties for the yield over a period. That is the reason that we feel in our case it is not a disadvantage.

Mr. Brown: I think, if I could interrupt, that one of the points made in our brief is

that they are in the business of holding investment and real estate properties, and they feel they should be taxed on the same basis as other corporations and areas such as manufacturing and retail stores and so on. There is no proposal in the White Paper which would restrict the capital cost allowances claimed by other businesses, and Markborough feels very strongly that there should be no unique proposal to restrict the capital cost allowances available in the one segment of the industry, the investment real estate, that this company is interested in.

The Acting Chairman: In other words you regard the suggestion as being discriminatory?

Mr. Brown: Yes, that is right.

The Acting Chairman: Provided you are suitably engaged in your line of business.

Mr. Brown: That is right. You will find, for example, that a distillery could deduct interest on founds borrowed to hold their inventory, but a real estate company in the real estate development business could not develop the interest borrowed to hold their inventory or developing the land.

Mr. Magee: Then we get into the question, just to summarize, Mr. Chairman, of integration in a two-and-a-half year period. As we see it, and as Mr. Vineberg said for a company that is speculating in land that is attractive on a creditable tax, and it is also attractive to a company that does nothing. I think we are too young a country to do nothing, and a company like ours that wants to create new sources of income and build Canada—that is very discriminatory as far as we are concerned. As Mr. Brown has said, we are operating a business but we are being taxed differently from other businesses, and certain manufacturing companies have large deferred taxes. I looked up a few companies, and I find one company has $59 million, another $58 million, and another grocery company, if they build their stores themselves they are all right, but if we build them for them we have problems as well, and to us that just does not seem right.

It is now 12.30 p.m., sir, and I would like to thank you very much for your patience in listening to us.

The Acting Chairman: Do you feel you have covered the basic points, supplemented by the study of your brief?

Mr. Magee: Yes, Mr. Chairman, and if there are any other questions, we would be glad to stay here all day, if you could put up with us.

The Acting Chairman: Are there any further questions? If not, we wish to thank you; you have been very helpful.

The committee adjourned until 2.15 p.m.

Upon resuming at 2.15 p.m.

Senator Lazarus Phillips (*Acting Chairman*) in the Chair.

The Acting Chairman: We are in session, honourable senators. We have two briefs to be heard this afternoon in order to complete our day's agenda. The first is that of Budd Automotive Company of Canada Limited, and to represent this company will the following gentlemen please be good enough to come forward: Mr. Dawson, Mr. Black and Mr. Michael. The gentlemen to my immediate right are Mr. Dawson, Vice-President, Finance; Mr. Black, Plant Controller and Mr. Michael, Financial Services Manager.

In accordance with our usual practice would you, Mr. Dawson, be the gentleman to summarize your brief. You may proceed when you are ready, sir.

Mr. L. G. Dawson, Vice-President, Finance, Budd Automotive Company of Canada Limited: First of all, I would like to say, honourable senators, that we appreciate very much being invited down to talk with you. Mr. Chairman has suggested that perhaps we are presenting a brief. When we first wrote our presentation we had no thought of making an official brief to anyone, because the gentlemen with me today are just my business associates. We do not represent officially the Budd Automotive Company of Canada Limited because the Budd Company of the United States, which is our major shareholder, will be making a brief officially on their behalf at some future time.

We, in effect, represent the people, the employees of the Budd Automotive Company of Canada Limited. We are not economists, tax lawyers or specialists, but we do have a vested interest—we are Canadians. When the White Paper was first presented we felt very strongly about it and thought it might be wise if we, as Canadians and proud of it, along with a lot of other people, would put our point of view across to whoever might want to be interested in listening to it. At the

same time that we decided to write the letter we also fully understood that there would be many experts and organizations in this country that would be interested. We knew that you would be flooded with a lot of this expert opinion. We decided to write our letter on the basis of the overall concept of the White Paper in the way we, as average Canadians, feel about it.

When the three of us completed our hours and hours of discussion and actually got all of this down on paper we studied the letter. For a little while we did not know what to do with it, because by the time we got the letter written a great many submissions had already been made, of an expert nature, to various committees and newspapers. We felt very strongly and still do about Canada and where we are heading.

Our thoughts are in our letter so we decided that perhaps if we felt this way maybe others would feel the same. We had a chance to prove this by taking the people in our own company. We decided to mail to the homes of all of our employees the letter which is in your possession so that they could discuss it at the dinner table. We suggested in the covering memo that was sent with it that if they felt, as we did, and agreed with that letter, perhaps they too would like to sign it along with ourselves. We set up a booth in the factory and three or four days later no less than 499 out of our 750 employees decided to agree with us.

We are a strong U.A.W. union shop. We represent over 20 ethnic groups. The people in our plant are just average Canadians from the area of Kitchener and Waterloo. Strangely enough many of the union committee people signed the letter along with us.

We feel very strongly about the points of view that we have put into this letter. We are not attacking any specific part of the White Paper, because we do not think that any part of it should be put into force.

The Acting Chairman: What was your last sentence?

Mr. Dawson: We do not thing or feel that any part of the White Paper should be put into law, because we think that the tax reform measures, as spelled out in the White Paper, go too far and will take us into an area that perhaps Canada does not want to go. Our background, our heritage is not socialism. We believe that when you buy the White Paper you are going on a one-way street to socialism. It is a blueprint for socialism. You will remove all the incentives and desires of people to be better or to do better.

We can discuss all day various and sundry parts of the White Paper, but there is not, in our opinion, very much wrong with Canada as we have built it so far. Why do we want to change it? There are obvious violators of our tax system. Naturally, we have got the crooks in this country the same as anyone else, but we also have the tools, the laws, the methods and the ways of catching those crooks. What is wrong with our administrative system as it is? It brought us a long way so far and we can go a lot further.

If there are any questions we would be pleased to answer them in any way we can.

The Acting Chairman: May I put the first question? Did you get an answer from the minister to whom you addressed the letter?

Mr. Dawson: I thank Senator Phillips for mentioning this. Gentlemen, when we finally decided to mail this letter we sent it to everyone from Prime Minister Trudeau, Benson, you gentlemen and everyone else you can imagine. You are the only people who were interested enough to call and talk to us a little more about it. We have not had a single reply from anyone else. I think that is disgusting.

The Acting Chairman: Honourable senators, are there any questions?

Senator Desruisseaux: Mr. Chairman, I would like something clarified. Mr. Dawson, say that you have accompanied your writings with lots of signatures. I assume that they were all employees?

Mr. Dawson: That is exactly right.

Senator Desruisseaux: You said a moment ago that you had a union shop.

Mr. Dawson: The U.A.W.

Senator Desruisseaux: Will the U.A.W. make the same representations as has been made by you?

Mr. Dawson: I am not in a position to answer for the U.A.W. In my opinion in this day and age, when you work in a manufacturing company such as we do, there are three entities in that company—the management, the union, and the people who work there. They are altogether different bodies of

people, and the union and their motives, desires and objectives are quite frequently different.

Senator Desruisseaux: You say that they approve of the representations that you have made, but I do not think we have had enough of the other side, the labour and the union people before us. They have hesitated and have made very little representations to us so far. If they share these views, I think they should send forth something as to their views.

Mr. Dawson: I agree with you, sir. I think they should step forward as Canadians and do so. I understand the CLC has been here.

The Acting Chairman: If you were asked, Mr. Dawson, your reaction to three or four of the most important features in the White Paper that do not appeal to you, and to those who have subscribed, the 499 people, are you or any of your colleagues in a position to identify them?

Mr. D. J. Michael (Financial Services Manager, Budd Automotive Company of Canada Limited): Before we do that, Mr. Chairman, I wonder if I could say something in respect of the senator's question. The other day I went out to the boys on the floor and I was asking them if their feelings had changed about the White Paper, and when I asked the fellows, they basically felt the same way. When I asked the union people, the stewards and so forth, they did not want to commit themselves because the UAW is having an official meeting on May 10th in Windsor, and the union people would not make any comment at all until after. But when I talked to them as man-to-man type of thing, they still agreed.

Senator Aseltine: Your company wishes to leave things as they are? You wish to have the whole question of taxation left as it is now rather than to adopt the provisions of the White Paper?

Mr. Dawson: I think, of course, there is no such thing as a perfect system, and I think there should be people in government constantly reviewing and analyzing and perfecting the tax system in Canada.

Senator Aseltine: You say in the last paragraph of your brief that the White Paper if implemented would change the basic character of Canada for generations to come. You say that people will be changed from independent, resourceful, hard-working, look-after-your-own type to a large mass of bodies completely dependent on the socialistic welfare dependency and so on.

Mr. Dawson: I believe every word of it.

Senator Aseltine: You don't want to have anything to do with the White Paper then?

Mr. Dawson: No, sir. I do believe the present system can be improved upon but I don't think we need complete tax reform, because I don't think we should remove the incentive and desire of people to get ahead. On April 4th in the *Financial Post* one of the senior government officers of the Department of Finance made the following statement:

> Many of the faults of the old system ... have had an important economic significance, which makes reform difficult. They favoured those who saved and invested their savings and accumulated wealth.

And I ask what is wrong with saving and accumulating wealth? That statement was made by Mr. R. B. Bryce, Deputy Minister of Finance.

Senator Everett: Mr. Dawson, on page 2 you say—"It can be stated unequivocally that this company would not exist today in Canada if the proposals and the principles contained in the White Paper were in effect."

Mr. Dawson: That's right, sir.

Senator Everett: Could you delineate for us the provisions of the White Paper that would have prevented Budd from establishing a Canadian plant?

Mr. Dawson: I would be pleased to, sir. I was the first Canadian employee of Budd Automotive Company of Canada Limited back in September, 1965. We got together a company to make a product that had never been made in Canada prior to that time, a car frame for passenger cars for a large automotive company. There was no prior experience in Canada. The Budd Company of the United States came into this country and they came to Ottawa and asked in what way could they be good corporate citizens. They surveyed the various areas of the country to build their plant, which was a result of the Automotive Trade Pact, providing the 750 jobs we are referring to in the letter. They had a choice of going into some of the depressed areas and taking advantage of the tax system and so on and so forth. But they didn't. We settled in

Kitchener because Kitchener is noted for its hard-working productive people who have not yet been corrupted by the welfare society and the great demands that the unions have been making on our society in the last few years. We even approached the Tax Department for guidance on how to handle some of the many, many problems of building a $25 million plant of a type that had never been built in Canada before, and the tax people said "we will give you all the advice you like, but it isn't binding. You cannot believe anything we say because it can be changed tomorrow." As a result, we have gone on and we have built that plant. Last fall, we were so successful in the last two years, that we bid and successfully got contracts from all our competitors in North America which has resulted in a $40 million expansion which we are just half-way through right now.

That American company went public, offered shares in Canada to the Canadian public, and if the White Paper goes in and if our projections and our growth which is very real comes about, our stocks, which at the moment is somewhere in the neighbourhood of $5 a share, when we take our company from its present $25 million annual volume to perhaps $65 million or $70 million annual volume in two years, should appreciate in value, and if it appreciates the way we expect it to appreciate, our majority shareholder, the Budd Company, for doing all these things is going to be penalized under this new revaluation of capital gains $7½ million, and I think they have every right in the world to be incensed.

Senator McLean: What was the offering price of the shares when they were offered to the public?

Mr. Dawson: When they first came out, they were attached to debentures as part of a unit with warrants, stock and debenture and in that unit they were priced at $7.69. Now they are selling at around $5. They have been as low as $4.75, but we have been guaranteed by our underwriters that they will not go below zero.

Senator Desruisseaux: Have dividends been declared?

Mr. Dawson: No, we are prevented from issuing dividends at this point in time until our expansion is completed and we have decreased our long-term debt. We are about to issue a new debenture at the moment.

Senator Everett: So there are two main provisions that would cause Budd to make the statement on the proposed capital gains tax, is that correct?

Mr. Dawson: Correct.

Senator Everett: And number 2 is the fact that the valuation is on the market value as of the date of valuation?

Mr. Dawson: That is correct.

Senator Everett: That is rather an inelegant statement.

Mr. A. W. Black, Plant Controller, Budd Automotive Company of Canada Limited: I think perhaps there might be two other considerations that could be added. The fact this company is growing to the extent that it is, capital cost allowances place the company in a taxable loss position. In such a case we do not pay income tax and we do not develop a creditable tax. So if, say, in one, two or three years hence the company decides the shareholders should receive the dividend, they would likely not receive the creditable tax.

Another point which enters into his is this unknown state of what may happen with capital cost allowances, sales taxes and excise taxes. We have mentioned and feel that these are really all one package, and they must be evaluated and brought to light at the same time rather than being done on a piecemeal basis. This is really another factor related to the two you mentioned in the first place.

The Acting Chairman: Do I gather from your last remark that you are not in favour of the proposed system of grossing income with corporate income, individual income and all that sort of thing, and working out the creditable tax credit; or would you prefer the present system?

Mr. Michael: Basically, what happens on that is that we have a growth company, and our company is growing. As you know, under the proposals of the White Paper, in order to give our shareholders any tax credit, if you will, we must have paid tax and therefore have a creditable tax to pass on to our shareholders; but because we are growing and because we have a $40 million expansion, and some of these other reasons, we will not have this creditable tax to pass on to our shareholders. Therefore, this is bound to affect the price of our stock.

The Acting Chairman: I think you are raising a very interesting point. You are a corporation that falls into the category of high capital expansion?

Mr. Michael: That is correct.

The Acting Chairman: On the capital allowance rates at the present time, you are either reducing your income available for distribution or it is putting you into a tax deficit position, so that if dividends were declared, which might be justified on a corporate basis, you have not a basis for a corporate tax credit to the recipient shareholder?

Mr. Michael: That is correct. In other words, they would be charged the full personal tax rate, without any benefit of this.

The Acting Chairman: So, in effect, for corporations that are expanding, if their expansion is reflected in the necessity of high capital cost extension, the net result is detrimental to the individual shareholder who receives a dividend?

Mr. Michael: That is correct.

The Acting Chairman: I do not think that was brought out in prior briefs as dramatically as it is here.

Mr. Black: This might be taken a step further, in that if a company expanded continuously they might be in a position where they could never have a dividend policy.

Senator Cook: Is your main objection to the capital gains tax based on the five-year income equalization?

Mr. Dawson: We do not believe that Canada, in her present state of development, should have any capital gains tax. If in the wisdom of Government it is decided we should have a capital gains tax, we definitely do not think we should have a re-evaluation, but we do not believe we should have capital gains. We do not believe that if rape is inevitable, you have to lie back and enjoy it.

The Acting Chairman: If you did have the capital gains tax, would you prefer the system referred to in the White Paper or an alternative system?

Mr. Dawson: We would prefer an extension and improvement of today's system, without disturbing the social aspect of what has made our country as great as it is today and what is going to make it far greater tomorrow.

The Acting Chairman: But if you did have a capital gains tax, should it, in your opinion, be included in taxable income, or should there be a special rate applicable to a special category?

Mr. Dawson: There should be a special rate applicable to a special category.

Senator Beaubien: Mr. Dawson, do you pay your employees a high rate?

Mr. Dawson: We are quite proud of our company because of the way we started and the fact that we started from scratch, and it had never been done in Canada before. Quite frequently you hear in Canada, "Well, we are not as good as the United States because our people are not productive enough; we do not have the productivity." We submit that if you put the capital, the tooling and the market together, the people in Canada are every bit as productive as anyone anywhere. We, fortunately, have been in a position to prove this statement. Our wages of our direct labour producing people in our plant at this moment in time are $4.40 an hour on the average. They work on an incentive basis, at a base rate of $2.70. Last year, when the UAW negotiated with "the Big Three" for the so-called wage parity, they called "wage parity", for purposes of definition, $3.65 an hour in 1971.

Senator Beaubien: And you are paying $4.40 now?

Mr. Dawson: Yes, right now, based on the productivity of our people. By 1971, if our people maintain their present levels of productivity, our direct labour machine people producing those frames will be making $4.70 an hour or the equivalent of $10,000 a year.

Mr. Michael: This is based on the incentive, which is a very important point.

Senator Molson: What is your union?

Mr. Dawson: The UAW. When we reached our peak of production after we started the plant the engineers designed our finished lines to produce somewhere in the neighbourhood of 60 units an hour. Our people, when they hit their stride, averaged 75 to 80 units an hour. The reason we won these contracts this past spring, which allowed this expansion that we have referred to, was in great part due to the productivity of our people.

Senator Molson: These are all frames?

Mr. Dawson: Car frames for passenger cars.

Senator Beaubien: Mr. Dawson, do you make these for one kind of car or all different makes of car? What kinds of frames are they?

Mr. Dawson: I can tell you in detail.

Senator Beaubien: No, just roughly.

Mr. Dawson: We make them for large passenger cars for two of the large automotive people in Canada and the States.

Senator Beaubien: So a lot would go to the States?

Mr. Dawson: Yes. Our future expansion is mostly shipped to all centres of the United States.

Senator Beaubien: You would be providing the frames for all parts of the United States?

Mr. Dawson: Yes. We are designed to produce anywhere from 400,000 to 450,000 frames a year at the present plant level. When this expansion is complete we will have production capacity which will hit 1,400,000 frames a year, and we will be shipping to all sources. We took those contracts in competition with all our competition in the States.

The Acting Chairman: Are there any other questions, honourable senators?

Mr. Dawson: Do you read *Weekend* magazine?

Senator Molson: Sometimes.

The Acting Chairman: Yes, we do.

Mr. Dawson: Last week, the issue of April 26, there was an article entitled, "Britannia Has Lost Her Glory". It is an article on ordinary people like us coming to Canada for an opportunity that has been lost to them in England. Over one million people have left England or the British Isles to come to Canada in the last few years, and here are some of the reasons. I will just quote you a couple of sentences:

> A married man without children who makes $5,200 a year will find only slightly more than $3,900 in his annual pay packet after paying 22.8 per cent income tax. If he is one of the fortunate few who makes $26,000 a year he will pay 42 per cent of this in income tax.

Under the White Paper, gentlemen, at $24,000 a year he will be paying 50 per cent. There were specific examples of families There was a young man and his wife and two children coming to Canada. He said:

> I'll also be a department head in Ottawa whereas in this country, my age would be against my getting such a position. . .The taxes are just too high to allow anybody to save any money . . . I love England, but I detest the people who are running the country. If I have any kids I don't want them raised over here. They haven't got a hope in hell. There's no pride left here, no initiative to work. Everybody seems to want something for nothing. The only way to survive is to fiddle and the only people who are doing well are the crooks.

These are people leaving the greatest country in the world from where we all came originally. The country over there has deteriorated since World War II, and the White Paper in our humble opinion is going to send us down the road towards that same condition. The country that is supposed to have lost the war has recovered very well, but its people haven't done it under a welfare socialistic society. They have done it by work, desire and incentive.

The Acting Chairman: Are there any other questions?

Senator Desruisseaux: I have one more in relation to the letter that you sent to the Finance Minister, Mr. Benson. I am referring to page 8:

> Without question, the proposals, if adopted, would retard capital formation (the very essence of our industrial base), change the outlook of our labour force . . .

They think it has a special bearing.

Mr. Michael: Talking again to people in the plant and people in the office, and so forth, they very definitely will say to you and me at some point in time "Why struggle any more when I pay it all out in taxes?' One of the foremen I happened to be talking to the other day received an increase. He laughed and said, "I guess this is about the last increase I will be able to take home, because from now on the Government will have it." He said, "Why should I continue working on this basis?" There are fellows who have gone to night school to upgrade their education and they feel the same way. Again I am talking about people I know and whom I have been talking to.

At paragraph 8.37 of the White Paper the Finance Minister makes statements about this type of thing. He says:

> The proposals in this paper involve some increases in marginal rates up to incomes of $15,000 or $17,000. These increases may have some modest effect on the incentive to work overtime or more intensively or to seek advancement by extra effort or training.

He does say that the tax increases are one thing, separate from tax reform. I do not think tax increases are really tax reform. He goes on to say:

> On the whole, however, the increases do not seem large enough to change behaviour patterns in any marked degree.

I do not agree with that. It is a matter of opinion. People at the plant and my friends indicate that they are getting fed up with this type of thing. They ask, "Why continue to struggle?" I have a chum who has his own printing business. He is just about ready to go and work for somebody else. "Why should I continue?" This is a personal opinion. He is not a tax expert, but this is the way he feels.

Senator Desruisseaux: There would be no incentive.

Mr. Michael: That is correct. That is the way he feels and that is the way we feel and this is expressed by our remarks in the brief we have presented. This is a personal thing. I do not know if you can measure it statistically or any other way. I know that in talking to all kinds of people, this is what they are saying.

Mr. Dawson: Life is a game and life is highly competitive. It always has been and it always will be no matter what the Government legislates. If there is no gain to win, pretty soon you quit playing.

The Acting Chairman: You are representing 499 individuals and your basic point is that the White Paper diminishes effectively incentive for Canadians?

Mr. Dawson: That is correct, sir.

Mr. Michael: If I may add to that, there is no incentive in the White Paper for business—period! But, while we do represent these 499 employees, they are all workers and have to earn their living somewhere. The way they do that, and the way the country grows, is through the growth of business.

The Acting Chairman: The point is that you are here for individuals as you indicated earlier in your brief.

Mr. Michael: That is correct. I do not think the White Paper gives us the guidance that we want or that we need.

I don't know how many hundreds of thousands of people are coming out of schools, and there are questions about where they are to go. Business feels that, for many reasons, it cannot expand, and so there won't be enough jobs.

Mr. Dawson: There is no guarantee in the rate structure as proposed by the White Paper that five years following the introduction of the White Paper the rates will not become something else, because the Government, rightly or wrongly, uses the tax system to curb inflation.

The Acting Chairman: Are there any other questions? If not, we thank you gentlemen for having come before the committee to give us your views.

The Acting Chairman: We have our last brief for today, the Conwest Exploration Company Limited. They are represented by Mr. Connell, who is Treasurer, Mr. Lamacraft, Chartered Accountant, and Mr. Elliott, the President.

We do not want you to be discouraged, for there is a precedent in the bible that the last shall be first. Mr. Elliott, I take it you will be representing a summary of your brief.

Mr. C. R. Elliott President, Conwest Exploration Company Limited: Mr. Chairman and honourable senators, my company and its controlling shareholders appreciate this opportunity to present to you our views and we hope we may be able to supplement what has been said in our brief.

By way of background to our remarks, I would like to say that in the period 1952 to 1968 inclusive, the company expended in its exploration program at total of more than $17,000,000 of which about 3.5 millions were paid for by associates in specific projects and the balance of funds were provided from the company's income and capital gains realized through investment of the company's funds. However, the growth of the company's assets has resulted largely from two major exploration events, the development of United Keno

Hill Mines Limited and Cassiar Asbestos Corporation Limited, both of which were the outcome of the exploration activity of this company prior to 1952. These discoveries have been of significant benefit to the Canadian economy. As we no longer manage United Keno Hill Mines Limited, I do not have figures for that company but in the case of Cassiar Asbestos Corporation Limited, I can say that since its incorporation in 1951, it has sold its products in the amount of 230 million dollars, of which approximately 223 million were export sales.

We estima e taxes paid by it directly at $14,600,000 of which $6,500,000 is income tax and B.C. Mining Tax of $3,700,000. You might say that the federal treasury will now be collecting mining tax from our Yukon operations as well. Total payrolls amounted to $62,500,000. I may say at this point that any personal views on capital gains are very strongly similar to those of Mr. Dawson and his associates. I do not think that the capital gains tax as proposed in the White Paper is appropriate for Canada at this time. In fact I would go further and say that having regard to the need for accumulations of capital in Canada to own our own industries, I believe that even the estate tax is a detriment to the development of our country. Be that as it may, our greatest concern is with regard to the impact of capital gains tax on the company and its shareholders. The company's exploration funds during the 1952-68 period were provided about equally from investment income, that is dividends from companies like United Keno Hill Mines Limited and Cassiar and capital gains partly realized from the turning over of investment of surplus funds from time to time at a profit and more importantly from liquidation of the company's holdings in the United Keno Hill Mines and the reduction of its holdings of Cassiar Asbestos Corporation in order to provide ourselves with a diversity of funds, and to carry on the exploration business.

We pay our shareholders a very modest dividend. The rest of our income from whatever source goes into exploration in the hope that we can repeat on our efforts to date. The impact of the White Paper would have resulted in severely restricting funds available to us, not only the capital gains tax on any appreciation in value of our discoveries or our investment transactions, but also through reducing dividends that would be available from our investments.

The impact of the proposed quinquenial revaluation on any group of shareholders is, I think, dramatically demonstrated by this company and its shareholders. I have here a graph which I believe is included in the supplementary material that was given to you just now. It is appendix C6. Last fall, the company, through a subsidiary or an associated company carrying on exploration in Australia, learned of a development in the Australian company, Poseidon Reliability, which we thought might be important. We approached that company with the result that we invested some $300,000 Australian in 50,000 shares of capital stock of that company. That worked out at six Australian dollars per share. Part of the consideration was an agreement on our part not to sell that stock for at least a year.

In the meantime speculators in Australia, London and elsewhere pushed the price of that stock up on the basis of perhaps excessive optimism about the importance of the discovery—although it is invariably an important discovery to find nickel in Australia. The price went up to around $280 Australian or over $300 Canadian per share. Today that stock is selling about $90 Canadian per share, and as a result of our holding those 50,000 shares which we were unable to sell in the period of which I am speaking which is a seven-month period, the Conwest stock rose from an average price of about $11 to a peak which I think is shown in this graph as $15, but I think the actual peak reached based on the end month market was about $16 a share. Yesterday it was selling on the market at around $10—back where it started.

If the proposed quinquenial revaluation had been in effect, the two major shareholders in Conwest whose birthdays occur in the period covered could have been faced with an accrued capital gain of $4,124,000 and a tax thereon of $1,031,000. This would be in addition to other taxes that would have been collected on the ordinary fluctuations of the stock in other periods as set out in graphs C2 and C3 in the supplementary material. This would be quite a disastrous effect so far as the individuals are concerned and even more disastrous so far as control of that company which has been developed by the energies and experience of that family is concerned.

You have before you our recommendations with regard to capital gains. As result of reading those over before appearing here, I

want to make it quite clear that we do not recommend any form of capi al gains tax, but if a capital gains tax is inevitable—and to me it is astounding that the taxpayers as a whole, particularly those who are most likely to be affected by this capital gains tax, have been so docile in accepting the inevitability of this tax—however, that seems to be the case and with that in mind we have set out our recommendations in that regard.

In the first place we believe that if a capital gains tax is to be introduced into Canada, then it should be a separate tax, distinct from tax on income. Capital gains should not be in egrated with income in any way and, if taxed at all, it should be taxed separately and the rate should be a modest one. We are recommending it should not be more than 15 per cent with a lower amount for those in lower bracket and not exceeding half of what their income tax rate would be. We also recommend the complete elimination of the proposal to tax unrealized gains in any form, particularly the five-year revaluation period. I think that it is an unconscionable proposition to tax unrealized gains.

Now, dealing with our comments on the mining industry from the producing mine point of view, we have not been too exhaustive in our treatment of this. We have set out our views, but the Mining Association of Canada is submitting to you a further brief which will come before you and which will go into these arguments much more fully than I am able to do. I have made my contribution to that, and will no doubt have the opportunity of appearing before you again at that ,ime since I am on the tax committee of that body. The increased tax on mining income proposed in the White Paper will substantially restrict the funds available for exploration from producing companies and will reduce the discovery value of new ore bodies.

This is the most serious aspect, I think, of the proposals affecting mining companies. Its impact will be a disincentive. We have flourished since the end of World War II under the impact of the incentives that are presently written into the Income Tax Act. I do not think these incentives are excessive. As far as the three-year exemp ion is concerned, there have been isolated cases where, because of an unusually profitable operation that hits high profitability in the early stages, probably more tax exempt income was earned than was ever visualized when the provisions were introduced.

I may say that I do not regard this as any great hardship to the country, because this is the sort of prize that keeps people like Mr. Connell and myself in the business. If you do not get a winner once in a while you are as crazy as some people already think you are.

The other incentives are equally important from a financing point of view. If you cannot finance a development reasonably, there is going to be a lot of what is now ore that will become waste material and be left in the ground, and a lot of it will never be discovered.

Companies such as Conwest, which are dependent on income from other producing mines and capital gains, will find it virtually impossible to carry on constructive and profitable operations. The same will be true of the individual prospector, and with the elimination of the protection the Income Tax Act now affords, it is difficult to imagine that any individual prospector will survive, as such.

They may become employees of the large producing mines to the extent the proven mines continue their exploration programs, but even that implies that it becomes more difficult to ob ain, and the large companies tend to use more sophisticated methods that do not include that type of prospector.

Many of our recent finds have followed from the initial work of the individual prospector. Do not let anybody convince you that he is obsolete, because he is not.

That, gentlemen, is my introduction to our brief. If we can help you with questions that may arise we will be very pleased to do so. If I cannot answer them, then I will ask Mr. Lamacraft or Mr. Connell to answer them.

The Acting Chairman: Has the Bonanza experiences been considerable in the mining industry?

Mr. Elliott: I would say, no. I am sure that honourable senators have one or two outstanding situations in mind which, no doubt, had much to do with the proposal to abandon the three-year exemption. One is the Pine Point mine which, because of a happy circumstance, was able, even before the mill was built, to start shipping high grade ore, almost as high grade as the concentrate subsequently made out of the lower grade ores, and continued that for some time after the mill came into production. This is a circumstance that even that company did not realize until they got into the ore bodies.

I think that there are one or two others that have had somewhat similar experiences but, as a rule, in the early stages of the mines, if you get your investment back or earn the equivalent of your investment in the first three years without tax, you are very fortunate. Very few mines have ever done that.

I must say that one of our recommendations is that this circumstance of the Bonanza discovery taking undue advantage could easily be eliminated by limiting the exemption to three years of operation or an amount equivalent to the total investment.

The Acting Chairman: Would you regard the investment purely as equity or including the long-term funded debt?

Mr. Elliott: I think you would have to include the long-term funded debt. That is the only way you could pay the debt off.

Senator Everett: It would be the total expended?

Mr. Elliott: The total expended on exploration, development and capital plant, equipment.

Senator Everett: Including the town site?

Mr. Elliott: Including the town site. You cannot mine without a town site.

Senator Everett: No, indeed. But it is very interesting because the mining industry seems to have arrived at that as an alternative suggestion on the three-year exemption to what is proposed in the White Paper and what is in the present Tax Act, and there seems to be a fair amount of unanimity amongst the mining industry that this would cure any excesses that are involved in the present three-year exemption.

Mr. Elliott: That is our feeling. I cannot speak for the mining industry generally, but I am aware of the atmosphere, and I think that most mining executives are willing to accept that proposition as a fair one.

Senator Everett: Mr. Elliott, would you be able to tell me, excluding the three-year exemption, which might be characterized as a Canadian plus, what the present effective rate—this would be an average rate—what the present effective rate would be of the total provincial and federal taxes, as imposed under today's tax act on the mining industry?

Mr. Elliott: Depending on the province, it will be from a low of about 42 per cent to 47 per cent.

Senator Everett: Can you still undertake the risk of exploration and development at 47 per cent?

Mr. Elliott: Yes, I think that would be feasible.

Senator Everett: But I gather from the burden of your brief and from other briefs we have had, that it must be less than the general rate that is imposed on other corporations which you feel do not run the risks a mining company does.

Mr. Elliott: Right. I think unless the effective rate—including what the provinces or, in the case of the territories, the federal taxing authorities levy on income, as well as the corporation income tax levies by both province and federal—is something less than the general rate, there is no incentive left in those provisions.

Senator Everett: How long have you been in the mining business?

Mr. Elliott: I joined Mr. Fred. Connell, who was responsible for Conwest, in 1936. I am longer in the business than Conwest.

Senator Everett: So you pretty well have a lifetime in the mining business?

Mr. Elliott: Yes, I even had experience prior to that, because I used to audit his books.

Senator Everett: In order to keep Canada competitive in the mining field and to keep development and exploration at a high pace in Canada, and considering the overall tax rate that is available in other countries where competitive minerals could be mined, would you care to tell this committee what the best rate would be, what a fair rate would be for Canada to impose on mining companies in accordance with the definition we have been talking about, which is one of the imposition of full provincial and full federal rates?

Mr. Elliott: It is a very difficult question for me to answer. The different mining ventures are in somewhat different positions. The products of the Canadian mines have to compete in an international market even when you are selling the product in Canada and selling against an international price. At the present time, as you know, the copper price in

Canada is lower than the international price. At the same time, one of our major competitors is the United States producers, where the depletion rate is applied to the gross value; that is, the depletion rate that has exercised so much attention in Congress and in the press. It varies, but it applies to the gross value of the production of the mine and is limited to 50 per cent of the profits.

If the Canadian mines are paying effective rates of say, 57 per cent or 60 per cent, combined, you are competing with a mining company in the United States that is paying the effective rate of half of that.

Senator Everett: I do not think that answers my question. I know it is a difficult question to answer, but let me say this. In your brief you say that if the proposals of the White Paper came into effect, the rate imposed on mining companies in Canada will vary from 57 to 60 per cent before the earned depletion provisions are deducted. You say that if 10 per cent before tax is expended on eligible exploration, that will have the effect of reducing that overall tax of 57 to 60 per cent by just 1½ per cent.

Mr. Elliott: Percentage points or percent?

Senator Everett: It would probably be 1½. You have 1½ percentage points, so I imagine it is 1½ points. If 30 per cent was expended, that 57 to 60 per cent would be reduced, according to your figures, by 4½ per cent which, I think in arithmetical calculation, would be an overall tax of 52½ per cent to 56½ per cent. If those figures are correct, it would seem, on the face of it, that non-Canadian mining would be not only non-competitive with mining in other countries, but also would not even be competitive with normal commercial undertakings in Canada. I think it does become important, in trying to determine what a fair rate is, for you to say, if you can, what that overall rate should be.

Mr. Elliott: You are quite right. The earned depletion, as a substitute in maintaining an acceptable rate, is not significant to expend, say, more than 10 per cent on exploration. As defined in the White Paper, it seems like an impossibility. Even the 30 per cent that you mention still does not bring it down to where it would be a factor in reducing that to an acceptable rate.

The only way I can answer your question, senator, is to say that it would have to be something substantially below the applicable rate to all industry in order to retain some incentive.

The Acting Chairman: Would you say that the 10 per cent would be correct?

Mr. Elliott: Ten percentage points.

The Acting Chairman: If the corporate rates were 50 per cent, what would you think would be required for the resource industries in the way of incentive?

Mr. Elliott: If we had this 10 points...

The Acting Chairman: Say 40 per cent.

Mr. Elliott: Yes, 40 per cent. That would be acceptable.

The Acting Chairman: Would it put the Canadian industry in too attractive a position as compared with the United States, Australia and other countries? Would Canada be too generous to you if the difference between the Canadian corporate rates generally was 50 and the resource industries were given a rate of 40 per cent? Would we be making a mistake, speaking to you as a Canadian citizen, by being too generous?

Mr. Elliott: With respect to Australia, I think we would be getting about even, although Australia has peculiar laws. For example, there goldmining pays no tax at all. That would put us in line with Australia, but perhaps not as generous as the United States.

Senator Connolly (Ottawa West): Mr. Chairman, I apologize for being late. Perhaps Mr. Elliott has answered these preliminary questions already.

What kind of mines are you operating? What minerals are you mining?

Mr. Elliott: Asbestos. The Conwest does not operate mines. It is purely an exploration company. It owns 10 per cent of the capital stock of Cassiar Asbestos Corporation and provides the management for that company. We have two asbestos mines, one in northern British Columbia and one in the Yukon. In fact, the Clinton Mine in the Yukon is the closest operating mine to the Arctic Circle in Canada; it is something less than 150 miles from the Arctic Circle.

Senator Connolly (Ottawa West): You are arguing that the depletion rates, as they exist in the law now, should be retained?

Mr. Elliott: Yes.

Senator Connolly (Ottawa West): Because of the risk that is involved and also to encourage further exploration and development.

Mr. Elliott: And also to provide a certain degree of equity.

Senator Connolly (Ottawa West): The wasting nature of the assets.

Mr. Elliott: Yes, and the extra tax that the industry is accepting.

Senator Connolly (Ottawa West): On these questions I am looking for help here. We ran into a little difficulty yesterday, and I felt it might be appropriate to take advantage of your presence here. Perhaps you can help us a bit.

I take it that the three mining properties which you manage and which are non-metallic mines are located on fairly well delimited ore bodies.

Mr. Elliott: Yes, senator, up to a point. I say up to a point, because they are delimited to the extent of capability of open pit mining under today's available equipment and technical know-how.

Senator Connolly (Ottawa West): Have you had profitable years? How long have these mines been in existence?

Mr. Elliott: Cassiar was officially in production, I think, the 1st of July, 1955. We had some minor production prior to that.

Senator Connolly (Ottawa West): From 1955 it has been an operating mine?

Mr. Elliott: Yes.

Senator Connolly (Ottawa West): Has it made a profit?

Mr. Elliott: Yes.

Senator Connolly (Ottawa West): I do not want to know the amount because I am asking a general type of question.

Mr. Elliott: It has been profitable.

Senator Connolly (Ottawa West): There are no tricks involved in this. We really want information rather than to cross-examine you. Can you say relatively the same thing about the other mines which you have under management, that they have been in a profitable position for a number of years?

Mr. Elliott: We have at the present time two asbestos mines under our operation, the first one is the Cassiar Mine und the second one I mentioned is the Clinton Creek Mine which has been in operation for approximately two years now.

Senator Connolly (Ottawa West): And profitably?

Mr. Elliott: And profitably.

Senator Connolly (Ottawa West): And would the life of these two mines be considerable?

Mr. Elliott: I would say that on the basis of the present reserves, we have about 25 years for each one.

Senator Connolly (Ottawa West): That would be the life of each of these mines?

Mr. Elliott: The Cassiar Mine has already operated for 15 years so that would be a total of 40. When we opened up, we estimated 30 years.

Senator Connolly (Ottawa West): Well, now, here is one of the problems that faced us yesterday and that is that a mining company that has been getting the depletion, and all of them have, and is able to operate at a profit, if they project their operations into the future, they will perhaps be paying higher taxes, but perhaps not taxes which would put them out of business. Now at the moment I ask you to forget about the idea of incentives and about the idea of the restoration of equity, because of the wasting nature of the asset, and simply to consider the bare items on the balance sheet. If you continue to operate without the depletion, you would be, I take it, simply paying higher taxes, but would they be so prohibitively high that you would not be able to make a profit?

Mr. Elliott: I will answer that by referring strictly to our own companies of which I have some knowledge and say no. As far as the mine is concerned, we could certainly continue to operate, having found the ore body and having brought it into production.

Senator Connolly (Ottawa West): Let us make it clear to each other and to the committee that we are talking about an ore body with a life of approximately 25 years in each case. Therefore it is not necessary to go in for further exploration. Now, what is the situation when you are restricted to that?

Mr. Elliott: That ore can be mined out without the depletion allowance, and I do

not think there would be any question about our mining it out. Some of the ore might be left behind, but it might reduce the life depending on the impact of the mining tax in the location where the mine is situated. You cannot move a mine.

Senator Connolly (Ottawa West): Yesterday, Senator Molson, Senator Hayden and I were puzzled about this aspect of it and we still do not know the answer. In respect of existing mines, when you do look at projections for the future, it looks as if these companies would be able to continue the exploitation of these existing ore bodies even if the depletion were removed. Now if that is the case, how do you answer the people who say "why should we give these existing mining companies the depletion on a continuing basis? They are going to make profits anyway and they are going to pay taxes anyway. They have to pay a little more in taxes, but they are still going to be able to carry on a profitable enterprise".

Mr. Elliott: I think the answer to that is that if the impact of taxes is to reduce the rate of return so that that return is no longer attractive to new capital, then it will discourage development of new ventures with the exception of marginal mines which might very well be put in jeopardy. I think an existing ore body would probably be mined out because there is no other way to get your money back, but it would no longer be the attractive investment it was, and consequently you would have a depressing effect on the search for mines, if that developed as a general thing. I think that the rate of return that a successful mine is capable of is part of the reason that keeps the research for the replacement of that mine going. Perhaps I am getting outside the limit of your proposition, but I think this has to be taken into account in answering such a question.

Senator Connolly (Ottawa West): What is the present rate of return on those two mines?

Mr. Elliott: One of the mines is still in the tax exempt period.

The Acting Chairman: Senator Connolly, when you speak of rate of return, are we in the current year speaking of the yield on the net value of the assets at the close of the fiscal year, because those are the assets that are functioning when you speak of a rate of return as distinct from the original investment. Do we understand the question to mean that when you speak of the rate of return in 1970 where we have the shareholders owning assets that have a capital value of—that is to say the net book value, then the rate of return in 1970, as I understand it, should be related to the net book value of the company at the close of the previous fiscal year because sometimes when you speak of rate of return, Senator Connolly, there is a misconception when people think in terms of the original investment.

Senator Connolly (Ottawa West): I think your question, Mr. Chairman, if I may say so with respect clarifies the answers given by Mr. Elliott now. I would suggest that he answers it on either of the bases proposed by the chairman.

Mr. Elliott: I think the only way I can answer that is on the basis of the capital and surplus invested in the company as at the end of last year compared with the earnings for last year which would be better than 15 per cent.

Senator Connolly (Ottawa West): And what would it be under the proposal in the tax paper? Could you give me just an estimate?

Mr. Elliott: Oh, it would reduce it to something less than 13 per cent. That is an off-the-cuff figure.

Senator Connolly (Ottawa West): I think then that 13 per cent of 15 per cent would be the reduction. Now 10 per cent would reduce it by about $1.50. Would it not be fair to say that it might be too much of a discouraging factor to reduce that rate of return by 13 per cent?

Mr. J. C. Lamacraft, Chartered Accountant, Conwest Exploration Company Limited: If I might interject, Senator Connolly, I might say that it all stems back to the original investment decision. I think any venture, once it has been started up and is making money and as long as it continues to be profitable on an after tax basis would be allowed to continue as long as it could be profitably exploited irrespective of the rate of return. Because once having made a commitment and having started a profitable operation, as long as you can make a dollar profit you would continue to operate it.

Senator Connolly (Ottawa West): What we want to make sure of is that by the removal of the depletion allowance on a mine, be it either one of yours, we want to know wheth-

er it is going to cripple your future activity or not in respect of those two ore bodies?

Mr. M. P. Connell, Treasurer, Conwest Exploration Company Limited: I think it is safe not to speak of those two ore bodies, but the success and future of the enterprise depends largely on the ability of the company to continue to replace existing ore bodies that are being depleted and also to be in a position to take advantage of the growth of markets by finding new ore bodies. To the extent the cash flow advances exploration, capital replacement, dividends, working capital requirements, a 20 per cent reduction in the cash flow through an increase in tax payable is only going to come back...

Senator Connolly (Ottawa West): A removal of depletion?

Mr. Connell: Right, and it is only going to come back and you are going to have to cut out something. What are you going to cut out? We have made so many commitments of a capital nature that are absolutely requisite to the keeping of the operation in good health. It would seem logical, from my point of view, that exploration would be one of the first things you would probably trim back. I think this is where the discouragement would take place, and where the greatest danger lies.

Senator Connolly (Ottawa West): In other words, the discouragement does not lie in perhaps the adverse effect additional taxes have on ore bodies being worked, but it does have an adverse effect upon the replacement of the wasting asset, further exploration programs, the need for the company to go on and discover more so it can be a continual operation after the existing ore bodies have been exhausted?

Mr. Connell: Yes, I think I agree with that.

Senator Connolly (Ottawa West): I think these two answers, given both by Mr. Elliott and Mr. Lamacraft or Mr. Connell, have helped a good deal towards the problem that we had before us yesterday.

The Acting Chairman: I think so.

Senator Connolly (Ottawa West): Certainly, it helps me a bit.

Senator Molson: I do not want to muddy our thinking in that respect, but yesterday, in discussing this same problem, it was brought up in a way that did not suggest that the three-year exemption would be touched or that depletion would initially be touched, but that at some future stage, when the mine was fully established and perhaps all capital investment had been returned—I think yesterday I said even to the extent of 200 per cent—it might be possible to reduce or eliminate the depletion allowance.

I think in your reply, Mr. Elliott, you said it would not be crippling, provided it did not discourage new capital coming in. New capital coming in could still look forward to the three-year exemption, depletion, up to such-and-such a stage. It would only be after a mine is well advanced, is well established, working in a better delineated ore body, that the depletion would be reduced. So, I suppose the only effect such a change could have would be either to reduce the contemplated rate of dividends or to reduce the rate of exploration, although the return at that stage—having given effect to the depletion allowance up to that point, the depreciation up to that point, and the original three-year exemption—would be very high. So, I suppose the only effect would be that perhaps the dividend rate would not be as high as contemplated or, as you said, the rate at which exploration was carried on might be somewhat reduced. It could still be very high.

The Acting Chairman: Aside from these very effective observations, would you not consider what other countries are doing would be a very important factor in order really to get it into perspective?

Senator Molson: I think it would be a very important factor.

Mr. Elliott: Mr. Chairman, I was just going to comment to Senator Molson that what he is saying is probably true of, say, Cassiar and is probably true of, shall we say, Noranda Mines, both of which happen to have a product which is in short supply in the world today.

I am not too sure it would necessarily follow with regard, say, to a small lead mine or zinc mine where at the moment competition aboard is not yet cut off. But we in the mining industry are amazed that they are holding up so well. What happens when the United States supplies quotas to protect their domestic industry, as they have done before? I think that these are times when existing mines, when they run into those sorts of circumstances, would perhaps be pushed out of business earlier than they would otherwise

have been, but in any event it would not help them.

Senator Molson: I think perhaps too one of the weaknesses of what we are fumbling with by way of a suggestion is that we are really, in effect, suggesting changing the rules, if not in mid-stream, then somewhere down the stream, when the initial investment was made under a certain set of rules and we are suggesting that could be changed; and that certainly is a weakness.

The Acting Chairman: I think that, plus the international features, plus the overall observation that it is, after a venture industry as compared to an ordinary manufacturing industry, to say nothing of opening up the hinterland; and there is always the question of what should be the disparity between, say, the 50 per cent corporate rate and "X".

Senator Molson: And then the different markets, as Mr. Elliott said—asbestos, iron ore, and so on. There are so many conditions apply in the international markets.

Senator Desruisseaux: If in the past, in your historical past, you had not had depletion allowances, what would have happened to your exploration, development and expansion?

Mr. Elliott: I think, in probability, had we not had the incentive that we did have when we started to develop Cassiar, it would never have been developed because of apparent difficulties involved. We could see excellent fibre, but it was situated in such a manner and in such a location that I doubt very much whether we would have been able to entice the money in to do the development which has made it as successful mine as it is today.

Senator Connolly (Ottawa West): This may be a *reductio ad absurdum*. Suppose, for the sake of argument, we use Senator Molson's suggestion, and we come to the conclusion in this committee that the rules should not be changed in mid-stream—in other words, that existing mines continue to be subject to the tax laws as they now exist—and suppose we say that for the future, for newer mines, the depletion will only be allowed to be claimed for "X" number of years—10, 15, 20—what do you think might happen in the industry?

Mr. Elliott: I would have to say that providing the period of time was reasonable—you have a number of problems. Whether it is related to a corporation or related to a specific mine would be a factor of how long a period that depletion would be available. If it is related simply to the life of the corporation, that would be one thing. You may not know how long it is going to last. At any rate, some day it is going to run out. If you say 15 or 20 years it might be reasonable. I would think that that would affect the incentive aspect.

Senator Connolly (Ottawa West): There are some bodies which have been discussed in this committee that are projected ahead for one hundred years. If they were cut off after 20 years it might have a very serious effect.

The Acting Chairman: Are there any other questions honourable senators?

Senator Everett: I have a question on another subject. You propose that there be a separate capital gains tax. You state in item 7 of your recommendations that the integration proposals be made or be changed to place shareholders receiving capital gains through a corporation on the same basis as if they had realized such gains directly. I can see that that is necessary, but can you tell me very briefly how it would work.

Mr. Elliott: Quite frankly, I have not got a solution to that other than the recommendation.

Senator Everett: In respect to mutual funds.

Mr. Elliott: Some established rate rather than the full integration as proposed in the White Paper.

The Acting Chairman: If there are no other questions, honourable senators, we will now adjourn.

The committee adjourned.

APPENDIX "A"

CANADIAN ASSOCIATION
OF REAL ESTATE BOARDS

Submission to

House of Commons Standing Committee
on Finance, Trade and Economic Affairs

and to the

Standing Senate Committee
on Banking, Trade and Commerce

in reference to

WHITE PAPER ON
"PROPOSALS FOR TAX REFORM"

APRIL, 1970

CAREB / 99 DUNCAN MILL ROAD, DON MILLS, ONTARIO, 445-9910

Submission To The

HOUSE OF COMMONS STANDING COMMITTEE

ON FINANCE, TRADE AND ECONOMIC AFFAIRS

And To The

STANDING SENATE COMMITTEE

ON BANKING, TRADE AND COMMERCE

In Reference To:

The White Paper On

PROPOSALS FOR TAX REFORM

By The

CANADIAN ASSOCIATION OF REAL ESTATE BOARDS

For Reference Contact
J.T. Blair Jackson
F.R.I., R.I.(B.C.)
RESEARCH DIRECTOR

APRIL, 1970

- INDEX -

SUMMARY

Housing and urban development are an important priority for the people of Canada. Construction, residential and otherwise, accounts for well over 10% of total employment and gross national product. Our potential has not been fulfilled; current needs are not being met. Aggregate tax increases, apart from being discouraging, have nothing to do with tax reforms. Accordingly, the proposed White Paper changes should be revised to limit the restrictions on economic growth.

The discouragement to enterprise which results from a capital gains tax should not be aggravated by selecting a level of tax assimilating capital gains to income in all cases except that of the sale of shares of Widely Held Canadian Corporations. The proposed exception should be made the rule. Long term capital gains tax rates should be no more than half the normal rates and should preferably be established at levels below those in the United States of America and the United Kingdom.

Prospective treatment of house and apartment sales clashes with declared government policy and desirable social objectives. The capital gains tax should not apply to the sale of a principal residence.

The proposed $1150 per annum rule is clumsy, ineffectual, unnecessary and not suited to achieve its declared objective. If, as stated, it is intended not to tax the sale of homes, they should not be taxed. All of the vexatious problems of valuation, distinguishing between capital cost and maintenance expenses for homes, record keeping, allowing carrying costs, rollover proposals, international migration, gifting of homes and enormous administrative burdens where no revenue is anticipated, are as unnecessary as they are undesirable.

The capital cost allowance system, as the White Paper suggests, has served Canada well. If, in the real estate field it has led to increased investment, so much the better. The three-pronged erosion of recapture of capital cost allowance in real estate sales should be abandoned or, at the very least, consideration of their merits should be deferred until the entire capital cost allowance system is reviewed. The impact of changes in real estate must be assessed having regard to recent changes in estate taxation and the proposed capital gains levy.

The whole system of creditable taxes in relationship to depreciable property operates to remove a substantial measure of the advantages that are intended to be conveyed by the capital cost allowance system. Passive holdings will be encouraged; active investment will be discouraged.

It is against our national interest to discourage non-resident investment in real estate. Indeed, particularly in relationship to debt by comparison with equity holdings, it is the most desirable of all forms of non-resident investment.

Deductibility of interest charges on homes bought should be related to taxability of interest on the balance of sale on homes sold.

The existing rules which would allow expenses and convention costs to the extent that they are reasonable and laid out to earn income, should be maintained. Employees expenses should be allowed on the same basis with the $150 per annum or some other limit, as an option only for those who do not furnish detailed probative records of actual expenses laid out to earn income.

Income averaging proposals are inadequate and far inferior to the recommendations on this point of the Carter Commission which are to be preferred.

The weight of change adverse to small business activity should be alleviated by tax deferrals modelled in reverse after the refundable tax provisions.

1. The Canadian Association of Real Estate Boards is a national organization. Its constituent members include 84 real estate boards, extending from one end of the country to the other, representing an aggregate individual membership of 25,500. These brokers, agents and salesmen, in turn, reflect a very wide range in the scale of their operations. A number of large enterprises are included; the overwhelming majority are associated with small business. Individually and collectively they provide services for many corporations - public and private - institutions, Federal and Provincial government departments and agencies, and, indeed, for millions of individual Canadians.

2. Our organization welcomes the opportunity to make submissions on the White Paper Proposals for Tax Reform. This initiative is to be commended as it will undoubtedly contribute to a more carefully considered restructuring of the tax system. We are heartened by the opening suggestion in the White Paper seeking discussion and review in the search for "the best practical proposals" (1.4).

3. We find ourselves generally in accord with the aims of tax reform as stated in the White Paper. There is, first of all, the emphasis on fairness with an admonition that the Royal Commission in underlining this point had "carried some of its arguments to extremes which the Canadian public would not support" (1.8). A second

main objective "is to see that the tax system does not interfere seriously with economic growth and productivity" (1.10). This we might prefer to express in more positive terms.

4. We are less satisfied that the actual recommendations of the White Paper are consistent with these stated aims. We are, for example, persuaded that a capital gains tax is fair. We are also convinced that the particular form of capital gains tax - or to be more exact, assimilation of capital gain to income - which has been propounded is not practical, fair or economically stimulating.

5. Every aspect of the White Paper is of interest to us. There are some recommendations which we favour. We hope it will be agreed that it will be more useful for us to concentrate our submissions on those matters where we have more expertise and in relation to which we consider that corrections or modifications are required.

The Economic Context

6. Economic considerations must condition our approach. Production must come before distribution. At the present time there is a worldwide shortage of capital. The price of such capital has reached unprecedented heights with no sign of abatement. Canadians must exert themselves to achieve the potential of which they are capable. As the Economic Council of Canada in its latest report entitled "Perspective 1975" has stated: "A very rapid growth in total savings will need to be achieved over the period 1967 - 75" (page 95).

7. There is great competiton to attract foreign capital. Against this background of need for, and shortage of capital we find somewhat disquietening the conclusions of the White Paper estimating reduction in savings of $525 million as a result of the proposed modifications. This figure is predicated upon the 1969 income level as extrapolated from the 1967 records. It would, in any event, have to be augmented by increases attributable to any growth and price rises in the intervening period. It makes no provision for any adverse impact domestically and internationally from those measures which might discourage enterprise irrespective of the availability of savings. Other government agencies have suggested that a starting point figure would more appropriately be measured at well over twice the estimate. In any event a decline in savings points in a direction opposite to the

trend which ought to be generated and which Canada's current situation and current possibilities demand.

8. In the face of the contraction of savings available by virtue of adoption of the recommendations, it becomes all the more urgent to examine those measures which may discourage enterprise or remove existing encouragement to enterprise. We ought not deliberately to encourage any such discouragement of economic activity. Expressing it in another way those elements of the White Paper which appear to be harassing in their effect, impractical in their application or unduly complicated in relationship to the revenue that might be obtained should be scrutinized all the more critically in the light of overall adverse effects.

Tax Increase

9. Without joining in the debate as to the total amount involved and whether it be in the neighbourhood of $600 million or $1.2 billion per annum, the total increase in taxes imposed by the White Paper has nothing to do with tax reform - except to make it more unpalatable. Although there is a professed determination to reconstruct a tax system initially yielding amounts equivalent to the total tax revenue at the present time, the growing bite during the transitional period substantially increases total tax take. The total volume of taxation is a matter of fiscal policy subject to continuous review by Parliament. Measures to reform taxation should not be manoeuvred to augment taxes. A good part of the increase during the transitional five year period arises in relationship to capital gains. Hence, it is in this area that appropriate correctives might be established. This consideration in itself strengthens the case for such modifications - in addition to the merits thereof to some of which we now turn.

Capital Gains Tax

10. A capital gains tax appears fair and equitable. For this reason it merits support even though it may contribute relatively little to government revenues. A short term gain within, say, six months or one year from date of acquisition, may well be assimilated to ordinary income and taxed accordingly. We part company with the White Paper in its assumption that long term capital gains are no different than ordinary income. Amongst other differences the former reflects an increment in value which may occur over a long period of time. The latter is of a regular recurring nature. An annual income tax rising sharply on a progressive scale is well attuned to measurement of income that accrues year by year. It ill fits capital gain. The distortion and resulting unfairness becomes all the more accentuated - as the Carter Report itself emphasized - if the progressivity of tax rates is not attenuated by reasonable income averaging arrangements. Income averaging formulated in the White Paper falls far short of any reasonable requirements and is much inferior to the Carter recommendations in this regard.

11. Economic considerations cannot be ignored. To move at one fell swoop from a 53 year old system where capital gains are tax free to one where they are suddenly taxable at full rates (with the exception of the shares of widely held Canadian corporations) imposes far too

great a shock to the Canadian investor. As the White Paper itself underlines, in dealing with other matters such as the maximum rates of corporate taxes, there must be due regard for the level of competing tax rates elsewhere (1.20). At best it will take some time before "the ostentatiously high rates now in use", as so categorized in the White Paper (1.31), are reduced.

12. Under all of these circumstances, it seems imperative that any tax on gains be at less than full rates. One reasonable proposal might be to render uniformly applicable the degree of tax selected for sale of shares of widely held Canadian corporations. In any event, the rates chosen should be perceptibly lower than those prevailing in the United States. In relative terms Canada is still a young country economically with investments and enterprise falling far short of maturity. Capital gain taxation cannot be divorced from the already heavy increment in estate tax recently adopted. The White Paper conclusion appears to be an "overkill" which neither considerations of fairness and equity nor encouragement of economic development can justify. Both for domestic and foreign investors discouragement wrought by the change may well harm Canada's economic prospects. Even the United Kingdom with its far more mature economy and with investment already regulated by stringent foreign exchange control systems only adopted a capital gains tax in two stages. At that it opted for a rate lower than the general income tax levy.

Housing and Apartment Needs - Government Policy

13. In its declaration of principles the Federal Task Force Report on Housing and Urban Development published in January 1969 declared:

"i. Housing and urban development are an urgent priority for the people of Canada and must be treated as such by their elected representatives at all levels.

ii. Every Canadian should be entitled to clean, warm shelter as a matter of basic human right.

iii. While it will take some time to realize this goal, a concerted effort is required by all concerned - governments and the private sector - in the years immediately ahead. A minimum objective must be to produce 1 million additional housing units within the next five years.

iv. Within the natural constraints of geography and necessary economic and social limitations, the aim of government policies should be to generate sufficient housing stock of various forms so that all Canadians may exercise their own freedom of choice as to the style and tenure of housing in which they live." (at page 22)

14. In a speech to the National Concrete Producers' Association in Toronto on January 12, 1970, Mr. H.W. Hignett, President of the Central Mortgage and Housing Corporation, expressed the requirements for the current

decade in precise language:- "Housing production must reach about two and a half million units between now and the end of 1979 - a million more than in the decade just ended......These are not just figures of what is desirable for housing. They indicate only the basic volume imperative to prevent any loss in the progress we have been making in the supply and demand situation......I am sure all of you are aware that the federal government, in the face of these needs, has undertaken a firm commitment that no fewer than a million new units will be produced in Canada during the coming five years." He then went on to emphasize that this must be accomplished by the "private sector" of investors. In the face of such imperative needs and assurances, the White Paper provisions on housing, capital cost allowances and their consequences for future development create quite a jolt.

Capital Gains on Houses

15. We are deeply concerned, as the Minister of Finance appears to be also, about the proposed taxation of gains on homes. As the White Paper so aptly expresses it "Home ownership is part of the Canadian way of life". Already this way of life is being threatened and the opportunities for home ownership are being denied to all too many Canadians. The proposed measure would bar the door even more. Acquisition of a home entails increasing cost. Unlike a business, it leads to heavy upkeep expenses and not to any revenue.

16. Starting with his statement to the Standing Committee of the House of Commons on Finance, Trade and Economic Affairs on January 15th, 1970, the Minister of Finance has constantly reiterated that in proposing to tax the gain on the sale of homes "our aim is to rule out the ordinary house" (at page 26). The White Paper similarly expressed the hope that "Generally, capital gains on the sale of homes would not be taxed" (3.19). This objective would be accomplished by adding $1000 for each year of occupancy plus the greater of the cost of improvements made or $150 each year to V-Day value or original cost in the computation of taxable income.

17. Thus the whole cumbersome, costly, all pervasive and vexatious system is being offered apparently to cover the "extraordinary" and not the ordinary home. One would have anticipated that if it was intended to exempt ordinary homes nothing would be simpler than to say so. When the United Kingdom adopted a comprehensive capital gains tax system it found it quite possible and fair and reasonable to exempt any home which is used as a principal residence. The same model could well serve Canada.

18. With due deference, it appears to us that a clumsy, gimmick-type alternative is being proposed. A press dispatch of March 17th, 1970 quotes or misquotes the Minister of Finance as explaining that complete exemption from capital gains taxation on housing "would give wealthy persons a substantial loophole for investment". Even under the present law there is no such loophole. A wealthy person may collect jewellery or art objects but he cannot collect principal residences. By hypothesis, there can be only one principal residence. His choice must be dictated by living requirements, tastes and resources but not by investment proclivities. A wealthy man's home is usually a relatively poor investment in the business perspective of that term. The home is frequently tailored to his individual choice. The resale market is thin and highly volatile. We have borne witness to many cases where wealthy individuals have proportionately more often suffered losses on the

resale of their homes than is the case for other classes of the population.

19. Indeed, the singularity of the home as not being an investment in the commercial sense has been underscored in the White Paper recommendation that any loss on the sale of homes should not be deductible. In this particular respect, after paying lip service to the virtues of home ownership, the White Paper has been driven to treat the home owner in a worse way on disposition than the owner of other capital assets.

20. It should be a relatively simple matter, if there is a loophole, to plug it by providing that, barring evidence to the contrary with the onus of proof always resting on the taxpayer as it invariably does, that a home which is occupied only for a limited period of time, such as one year or less, should not be acknowledged as an intended principal residence. In this connection, the rollover provision propounded in the White Paper under which an exception would be made where the sale of the home was dictated by change of job and purchase of a home in another area would neatly fit as an appropriate exemption.

21. There are occasional instances where an unusual gain might be realized by virtue of sudden zoning changes or urbanization patterns. These are sufficiently exceptional and fortuitous as to place

them within the same category as lottery winnings which the White Paper does not intend to tax.

22. It must always be remembered that the home or the proceeds of sale thereof will be subject to estate taxes which have become much more substantial in recent years. In this sense even the occasional gain will not escape the net of the tax gatherer. After all, in the interests of practicality and convenience, the White Paper has no compunction about depriving the home owner who sustains a loss from any offsetting tax deductibility. The Government simply finds that it will be impossible to distinguish losses arising from changes in the real estate market and losses which arise from the aging of the house and normal wear and tear (3.19).

23. Furthermore, to a degree unparalleled in respect of any other capital assets, the home owner is beset by heavy municipal and school taxation. In recent years, says the White Paper, "Property taxes have been increased substantially". (1.5) In the speech already cited, Mr. Hignett referred to the growing tendency to "prohibitive assessment requirements" imposed by some local governments. The typical owner of a home is encumbered by continuing heavy interest charges on outstanding mortgages. In the United States pattern all expenses of this type are normally deductible

from income. If the home were logically viewed as an investment it should follow that taxes, interest and carrying expenses towards maintenance should be deductible from ordinary income. The White Paper is completely silent on this point. If provisions for taxing capital gains on homes is grafted onto the current law, unduly complicated problems will arise, virtually insoluble with any degree of fairness, as to that portion of these charges which should be attributable to consumer dwelling usage and, therefore, non-deductible and that which is attributable to the "investment" and consequently deductible. As the White Paper itself has stated, it is virtually impossible to draw a line between these two aspects.

24. The most frequent occasions for the sale of dwellings are likely to arise in connection with:-

(a) Death.

(b) Upgrading or downgrading.

(c) Older age when all the children have married and moved away.

(d) Change of jobs.

(e) Break-up of a home because of dissolution of the marriage.

25. There are strong social reasons, which the White Paper implicitly recognizes, that these typical realizations should not attract any tax. Added to that is

the compelling point that it is untimely and socially harmful to the welfare of Canada to discourage home ownership. The quality as well as the standard of Canadian living will be adversely affected. There will be less incentive to build new homes. There is bound to be a slowdown in switching residences to meet family needs and opportunities. The availability of a secondary market for such homes will contract. The shortage of decent homes and, therefore, of other dwelling places for Canadians will only be accentuated. No issue of government revenues is involved. Indeed it is painfully apparent that the self-imposed administrative burdens, quite apart from undue harassment of taxpayers, will inevitably result in a net loss on government revenue account.

26. The psychological impact of the prospective tax burden for the home owner will be all the more adverse because of two concomitant factors. Not only is it intended to tax the so called gain but also to do so at ordinary rates. In the year of gain, absent a reasonable averaging principle where the tax does apply, most of it is likely to impinge at the highest rates irrespective of the bracket into which the taxpayer normally falls.

27. The measures formulated can only achieve their stated objective of exempting normal sales by occasional happenstance. Any prefixed measurement, whether of

$1000 per annum or otherwise, is necessarily arbitrary and irrational. It has all the logic of a measure which would compel garment manufacturers to produce only the average size so that the tall and the short and the thin and the fat are left to fend for themselves because they don't fit into the norm. If the sum of $1000 becomes fair at one level of price acceleration it must necessarily be unfair at another.

28. To apply the same uniform $1000 per annum increment to all homes - whether at the $15,000 level or at the $50,000 level is in itself illogical, unfair and inequitable. For the $15,000 home it represents over 6½%; for the $50,000 home it is only 2%. If reference is made to the Task Force Report of "Multiple Listings in Metropolitan Toronto" (at page 16) the average price rose from under $17,500 in 1964 to over $25,000 in 1967. <u>On this basis in the average case the $1000 ruling would have fallen almost halfway short of its professed objective. If this applies to the average how much greater is the disparity if a broader median range is selected.</u>

29. By the same token, albeit to a lesser degree, applying the $150 measurement equally to the cheapest homes and the most expensive and to all of them in between defies all reason. If it is a fair measurement of likely expenditures for one type of home it must necessarily be unfair for all the others.

30. The same observations apply to any system which ignores the enormous regional and interurban disparities prevalent in Canada today. What is a fair and reasonable measurement for a period in one part of the country is not likely to be so for another. One of the worst features in trying to paper over these differences is that the greatest disincentive to home construction and home ownership would operate precisely in those areas where the needs are greatest and the disequilibrium between supply and demand will have forced prices upward the most. The circuitous method to exempt the sale of "ordinary" homes is highly imperfect and not likely to achieve its stated objective. By comparison with the simple U.K. style alternative the virtues, if any there be, pale into insignificance. Its burdens and complexities are immense.

31. A partial catalogue of some of the needless difficulties which would be engendered should give us all occasion to pause. These include:-

(1) Valuation

According to the Federal Report on Housing already referred to some 63% of the 5,500,000 housing units in Canada or 3,465,000 homes are owner-occupied. This creates for the taxpayers and for the administration 3,465,000 sets of valuation problems.

32. It is technically correct, as the Minister of Finance has asserted, that there is no absolute necessity for each home owner to obtain an expensive appraisal on valuation day, even if there were appraisers for the purpose. The valuation only becomes relevant in the event of sale, but even in such case the valuation must seek to establish value as of valuation day.

33. To a much greater degree than is the case with respect to stocks and bonds, a considerable lapse of time may ensue between such valuation day and ultimate sale. During such interval great changes may occur in the physical appearance of the home, its standard of maintenance may have risen or fallen. Even its size may have changed. Unlike the case of businesses which may earn income, there will be no financial statements available to reconstruct some fair semblance of valuation as at valuation day. There will be no stock market facilities or similar exchange records to determine recorded transactions of comparable units and thereby simplify valuation problems. The Minister of Finance has been driven to suggest that individual home owners might enquire from their friends and neighbours about pending sales around the time of valuation.

This type of approach may have some occasional relevance in the dullest of places where all homes are alike in conception, design, appearance and standard of maintenance. Otherwise it forces comparison of the unlike. In any event, such hearsay testimony has no probative value and is not even admissible.

34. Under existing rules, in respect of which no changes have been suggested, the burden of proof is always upon the taxpayer. This has been construed in such a manner at the Tax Appeal Board level and in our courts so that the benefit of any doubt is resolved against the taxpayer. The home owner, bereft of expert independent appraisal as of the date of valuation, will literally be at the mercy of the assessor. Even if the assessor was an expert in valuation, which he is not likely to be, he could not possibly have at the instance of sale arising long after valuation date the necessary data to provide for anything but the most arbitrary guess. Any such assessments are likely to vary with the individual vagaries of the individual assessor. The more conscientious the assessor, the more the difficulty and the more will be the time and expense involved in such arbitrary 'ex post facto' valuations.

35. The only clue available, at least in most cases, will be municipal assessment records. Although there have been some steps towards greater uniformity the relationship between such municipal assessments and fair market value remains subject to extreme variations not only between different areas, but also within many particular areas. To rely on such records as a method of determining value is about as unfair and inequitable a method of valuation as could be conceived. It would create far more differentials between the treatment of different Canadian home dwellers than could possibly arise by the blanket exemption of all gains on principal dwellings.

36. The taxpayer who does incur the expense of a professional valuation, must do so without any advance knowledge that the expense involved will ever achieve any purpose because it will be impossible for him to foretell whether at the time of ultimate resale his home has fallen into the category of the "ordinary" or "extraordinary". Furthermore, he must not only preserve the valuation but pray for the preservation of the valuator! If the latter be dead or unavailable by the time the report is to be used, it will not be admissible testimony.

37. (2) Capital Cost versus Maintenance Expenses

One of the most difficult problems of tax administration arises in the determination of those expenses, in relationship to building, machinery or equipment which falls within the category of capital costs and those which are ordinary maintenance. At least business firms subject to assessment all have records which enable both parties to determine, with reasonable fairness and subject to many borderline estimates, into what class any particular expenditure may fall. At that, vast administrative difficulties arise. Even for the home owner who keeps proper records, it will not be possible in any practical sense to determine what portion of the expense of paving the driveway, fixing the furnace, remodelling the house, installing new doors, repairing the roof, landscaping the garden or any of the other myriad changes constitute a capital "improvement" and what is ordinary repair. In dealing cryptically with "wear and tear", the White Paper has acknowledged that any such distinction is impractical and impossible (3.19).

38. (3) Records

A taxpayer's records are normally reviewed by the tax administration authorities within

no more than three or four years. Ordinarily, assessments will be outlawed by the statute of limitations after four years from the date of the first assessment following upon the filing of the taxpayer's annual returns. The home owner who keeps records of his improvements will have to preserve them in some cases for many years which could well extend to decades before there is occasion to refer to them in relationship to any realization on the sale of the home.

39. The authors of the White Paper abhor condemning Canada to become a nation of book-keepers but for many homeowners the $150 a year allowance will far from adequately reflect the improvements incurred. The alternative is almost interminable book and record keeping. The tasks of preservation are endless. It is surely not intended that future Canadian homes be constructed with special fire-proof storage appendages for such record keeping. What happens to the many victims of fire or other loss?

40. (4) Carrying Costs

Under existing tax laws the whole question of carrying costs is likely to entail endless litigation between home dwellers and tax

authorities to determine the deductibility of carrying costs - property taxes, interest and other charges. The businessman who is subject to a tax on the sale of his capital assets will have been allowed deductibility of equivalent carrying costs as they were incurred. Will they be similarly allowed to home owners? If not, will they be apportioned at the time of ultimate sale? Otherwise, are the results fair and equitable by comparison with the treatment of other taxpayers in relationship to non-home assets?

41. (5) Rollover

By comparison with United States standards, the rollover facilities permissible under the White Paper proposals are very limited. They apply only to the taxpayer "who moves from one area to another within Canada". What is an area? How will it be defined? Does it apply to a taxpayer working for a firm which moves from one part of town to another? If not, why not? How can we ever achieve any degree of fairness and equity in this category? Parenthetically we would suggest that the rollover should apply without limit to any taxpayer who moves from one home to another and uses the proceeds of sale of the former for acquisition of the latter irrespective of the

purpose. What counts for such a taxpayer is not simply the proceeds of the sale of his first home but also the cost of acquisition of the second one. In any event, the best solution to the rollover problem for principal residences is to remove any occasion to invoke it.

42. (6) International Migration

Denying the rollover when job requirements force migration elsewhere imposes undue restraints and freedom of movement for business or public purposes. An officer in the Department of External Affairs who is posted abroad may, during an inflationary period, have to pay quite a price on the deemed realization of his home, whether he sells it or not, and the disposition actual or deemed of all his other assets. A prospective temporary migrant to Canada very often offers useful skills and expert knowledge. The capital gains plans especially relating to deemed realization of all assets on departure will serve as a heavy deterrent. Exemption of personal dwellings would at least in a measure abate this particular element of discouragement of economic growth.

43. (7) Interrelationship with Gifts

In all events, the transmission of ownership of a home arising by death is subject to estate taxes. It is proposed to apply this to gifts. The gift tax rates have not just been increased but literally multiplied and may now run to 70% rates. The donor will additionally be subject to tax on the deemed gain arising from the gift as though he had disposed of the item gifted at fair market value. If a father gifts an expensive home to his children which, in the interim, has risen in value, there could be many situations where the combined impact of gift taxes and deemed realization taxes could well exceed a hundred per cent of the value of the home gifted.

44. One of the features of recent estate and gift tax legislation, much publicized, was the exemption of transmissions between consorts. Now the donor, under the White Paper proposals, will be deemed to have realized a gain based on market value at the time of the gift. Although the same husband and the same wife continue to live in the same home and may do so for many years to come an immediate tax becomes exigible by reason of the transfer from

one to another unless the increment in value is limited by the $1150 per annum formula.

45. <u>In some measure, this appears to undo the much vaunted freedom of transfer between husband and wife that was supposed to compensate for the extra taxes on estates and gifts otherwise imposed effective October 1968.</u>

46. A special unfair disability arises for Quebec home owners. When the recent gift and estate tax changes were debated in the Senate of Canada attention was directed to the fact that the then prevailing law of Quebec prohibited transfers between husband and wife, so that Quebec residents were deprived of the compensatory benefits available to other citizens of Canada. Government spokesmen in the Senate suggested that Quebec might change its law. While it is not suggested that this was the reason, in the event they did. Bill 10 has been adopted by the Quebec Legislature effective July 1970. It will thenceforth permit transfers between husband and wife in Quebec. <u>Unless he is sufficiently sophisticated to become aware of it within the short deadline period, the Quebec husband who wishes to place the family home in</u>

his wife's name for sentimental, security or other reasons, will in the future, foreshadowed by the White Paper, be faced with possible deemed realization taxes which may make it uneconomic to do so.

47. (8) Administrative Costs

If half the personnel of the Income Tax Department were devoted exclusively to home ownership valuations and calculations with no time or effort for anything else, it is doubtful whether they could do fair justice to all of the requirements. When it is considered that, in the end result, no revenue is anticipated, the question may reasonably be asked whether on this score alone it is worth the effort.

48. It is time to return to the emphasis, on the first page of the White Paper, about what is most practical. If we contrast what will be ahead if the White Paper proposals on home ownership are adopted with the alternatives available by the simple expedient of exempting principal residences, we hope that it will be agreed that the very postulates and principles of the White Paper, as compared with their detailed methods of implementation would support the simple, practical complete exemption formula and that such a conclusion will contribute more to fairness and equity than detract from it.

Capital Cost Allowances

49. While critical of so many other existing tax rules, the White Paper, like the Carter Report before it, reached the conclusion that our capital cost allowance system "has served Canada well" (5.11). Presently it is suggested that it has been so workable because the rates tend to be on the generous side (5.14). This issue is placed on the agenda for a debate deferred into the future.

50. Nonetheless it is proposed that there should immediately be introduced three changes all directed to, and concentrated upon, real estate holdings. Pre-judging the results of any general appraisal, these are referred to as remedies for "loopholes". There seems to be a tendency amongst those concerned with taxation to judge real estate harshly. Under existing income tax practice, disposition of real estate has been judged on an altogether different basis, both in administrative practice and otherwise, than sales of other assets in applying Section 139(1)(e) of the Income Tax Act even though the text of the law justifies no such distinction. This disparity was noted in rather strong language in the Carter Report when it observed: "Another inequity arises because in recent years there appears to have developed a marked tendency to seek to tax gains mainly on the purchase and sale of real estate, but not to assess gains

of a similar nature made on the purchase and sale of marketable securities. In theory both types of transaction should be subject to the same tax treatment and there appears to be neither logic nor equity in taxing the gains on one type of asset and not on the other" (Volume 3 page 331)

51. Before evaluating the loophole diagnosis it might be well to consider the nature and purpose of capital cost allowance. It provides for an apportionment of capital cost with the allowance related to, and limited by, the outlay. The current rates vary from 4% to 100%. With the exception of class 1 at 4% involving property that is a bridge, canal, culvert, dam, jetty, mole, road, sidewalk, airplane runway, or railway track, typical real estate holdings at 5% in class 3 already receive the lowest rates of depreciation. When the current system, characterized as having served Canada well, was adopted in 1949 the decision was reached after careful study. Initial rates were doubled over those prevailing but for almost all cases the residual balance principle was introduced. It was obvious then, as it is obvious now, that this would produce something in the way of self-starting acceleration in capital acquisition and expansion. An incentive was deliberately built in for the opening years - it is now being stigmatized as a "loophole" when it applies to real estate but not otherwise.

52. As occasion has required it the Government has considered it suitable if there is too much or too little development in certain regions to suspend or decelerate or alternatively to accelerate the initial rates of capital cost allowances. Where it is judged that there is too much building going on new construction may be denied capital cost allowance as is currently the rule for certain areas of the country. It cannot seriously be suggested that there is always too much construction. The annual value of Canada's construction programme has averaged over $7 billion in recent years providing the equivalent of 565,000 year round jobs on site with an even greater employment of Canadians off site in manufacturing, transporting and merchandizing the requisite construction materials and equipment required each year. All told the industry has accounted for something like one-fifth of the Gross National Product. At the present time many parts of the construction industry have been in the doldrums. An exceptionally high percentage of construction firms - large and small - have been driven into bankruptcy. Many workers have lost their jobs. This hardly seems an appropriate moment to single out new construction and capital acquisition of real estate for particularly and perpetually adverse treatment.

53. On the consumer side of the picture other government agencies have pointed to the need for more residential dwelling construction rather than less. As

the Task Force, already quoted has pointed out, there are some two million rental dwelling units in Canada, but except for one or two areas their supply is grossly inadequate to meet decent housing needs.

54. To characterize certain features of the capital cost allowance in relationship to real estate as "loopholes" is to imply that certain investors have been prompted to invest in real estate which they otherwise would not have been inclined to acquire. The 1949 system is attacked precisely because it achieved some of its intended incentive. It certainly has not achieved too much. We don't have too much employment in construction. We don't have too many apartments.

55. The very categorization of "loophole" represents a value judgment in itself. The Department of Regional Economic Expansion set up by the Government of Canada would look quite different to the public if it was labelled as the Department of Creation of Selected "Loopholes". Measures for stimulating growth in designated areas, steps to encourage scientific research, special stimuli to the shipping industry are all "loop-holes" in this sense. So is the entire capital cost allowance system. If it has led individuals to increased savings and investment, so much the better.

56. The real estate industry is already the target, and disproportionately so, of high municipal taxation. Prevailing interest rates and the relative sparsity of mortgage funds greatly hamper any development. The suggested changes should be studied in the context of other recommendations of the White Paper. Sale of real estate will now be subject, quite apart from recapture, to capital gains tax. It is proposed that no distinction be made between real estate investments in Canada and elsewhere. Unlike Widely Held Canadian Corporations, full rates will always apply on any real estate gains. Estate taxation rates have increased. Other types of assets may for some purposes be transmitted outside of the Federal or provincial estate or succession duty jurisdiction, but real estate is invariably sited within Canada and within the province where it is physically located and, therefore, invariably taxed.

57. Because many taxpayers "who would otherwise be in quite high tax brackets become landlords" (5.16) it is proposed that they will be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowances or by deduction of interest or property taxes. It is all very well to discourage landlords. But by hypothesis, in view of the residual balance principle, the greatest impact arises in stimulating or deterring new buildings.

The resultant disincentive to construct or the deliberate elimination of the incentive which now exists, will further disequilibrate supply and demand and augment rents all the more. Those landlords who already have benefited in the past from the so-called "loophole" will presumably obtain higher benefits from resultant increases in rents while potential competition is curtailed.

58. Again one of the changes wrought years ago, having nothing to do with capital cost allowance itself, involved adoption of the principle that in the computation of income in any particular year all profits and losses from all taxable sources should be offset against each other. This was a departure from an earlier phase of Section 10 of the Income War Tax Act under which taxable income could never be less than that derived from the principal source. There is no resurrecting the old rule except in limited relationship to "landlords" on the grounds that they "could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property". (5.17). But the White Paper itself proposes a much greater "loophole", if such it be, by allowing investors to acquire large amounts of speculative securities with the opportunity of realizing losses on those which go down and thereby eliminating income each year while retaining those which rise in value.

Except for real estate the thrust of the White Paper broadens the scope of offsetting profits and losses.

59. The proposal is all the more unjust and discriminatory because investors in all other categories are entitled to deduct capital cost allowances and interest on borrowed money used to earn income irrespective of any resultant loss. It is typical of many types of enterprise that they may lose money in the early years, but they are not accordingly subject to any particular tax penalty. If a businessman is wise enough or foolish enough, depending upon one's point of view, to embark upon new ventures in partial consideration of the net cost or net risk after taxes, either he should be allowed to do so - or to reflect the earlier view which has long been abandoned - he should not. What is there about real estate which merits a special castigation?

60. What the White Paper fails to mention is that individual investors in real estate are already precluded from deducting losses to the extent available to others. Any corporation, or an indivdual operator of a business who sustains a loss by virtue of capital cost allowances or interest on borrowed money can carry forward this loss against profits for a five-year period. Not so with the individual owner of real estate. Contrast for example the judgments in Tenir Ltée. vs. M.N.R. 1968

Dominion Tax Cases 589 and Leon Adler vs. M.N.R. 1970 Dominion Tax Cases 1087. If the interest and tax loss cannot be absorbed in the current year they are not available in the future. To the existing disability, the White Paper would add a further disadvantage to real estate holdings by limiting deductibility of interest charges and property taxes so that, when added to existing rules, what is not available in any particular year would never be available. Of course, capital cost allowances are in a different category because they can be taken at a later date.

61. The investor who is particularly hard hit because of the high initial rate of vacancies will be dealt a body blow by comparison with the investor who receives full rental income from the outset. In this situation the rule which might have been theoretically inspired by notions of equity and ability to pay would lead to considerable inequity and an incidence of tax which becomes all the greater the less there is such an ability to pay.

62. It borders on the ironic that the White Paper wants to chip away at a so-called "loophole" under the existing system when any such so-called loophole would be substantially narrowed by other measures. Today an individual investor may be subject to progressive income

tax rates ascending to over 80%. The White Paper proposes a maximum level of only 50%. Where an investor in real estate might have deliberately deferred taxes at the 80% rate under the old system he could never do so for more than 50% under the new system. Having regard to all the costs, risks and uncertainties of real estate investment, elimination of three-eighths of the maximum tax incentive should be more than sufficient to eliminate what the authors of the White Paper seem to have considered to be a measure of abuse.

63. It is equally ironic that this so-called loophole for rental buildings should be subject not to one but to three cumulative attacks. A separate depreciation class is to be created for each rental building that costs $50,000 or more in order that "there would be a day of reckoning for the owner of each large building". (5.17). It might be well to remember that there are other days and forms of reckoning anyway. The White Paper is proposing a separate full scale tax on the capital gain arising from the excess in sales value of the land and buildings over original cost. Secondly individuals inevitably die and their estates are subject to heavy taxation on real estate holdings. In the interim, as already mentioned, the burden of other taxes emanating from municipal sources is unusually onerous for real estate. To single out a rental building for this special adverse treatment may create unduly artificial

distortions in the market pattern. Quick sales of losing properties and the freezing of sales of successfully invested properties will develop in a manner which economic considerations alone would not engender. Needless administrative difficulties develop and new "loopholes" arise.

64. Suppose an individual investor in a building encounters a serious early vacancy problem. An immediate sale reflecting reduced value because the investment has not lived up to expectations will create a deductible "terminal loss" in a way not now available. Such a building owner could then virtually write his own ticket on the amount of depreciation available to him for the remainder of his holdings. The worst feature of this newly created loophole would be that it would only be available for wealthier individuals with a multiplicity of buildings. When it becomes applicable the results would be worse than the "abuse" intended to be corrected.

65. Most curious of all the loophole corrections is the proposal that an heir succeeding to ownership of real estate should inherit the same base for depreciation as the deceased had when he died. Dying is not resorted to as a tax gimmick. There is no need to penalize the heirs for the wrongs perpetrated on the tax authorities by the act of dying. With very few exceptions this act is usually quite involuntary.

66. Estate taxes will be based upon the value of the property as at date of death irrespective of how much capital cost allowance may have been accumulated in the past. Furthermore, if the heirs at any time in the future sell the property, whether to pay estate taxes or otherwise, the measure of taxable gain - by virtue of other recommendations of the White Paper - will be the difference between the original cost of the property to the deceased plus the allocable portion of the estate tax and the resale price. The cumulative results are mighty serious.

67. What possible justification can there be, theoretically or otherwise, for isolating capital cost allowances taken by the deceased prior to his death and taxing them in the hands of his heirs upon resale of them? The essence of the capital cost allowance is that it is a deduction from income. It is the deceased who has received the income, not his heirs. To the extent that deferment of tax is implicit in capital cost allowance that has not been offset by declining value of the building the heirs will be subject to estate taxes. Above the $300,000 mark the excess will be taxed at 50% on estate tax account alone. The White Paper does not offer any credit for estate taxes on recapture as it does for capital gains tax generally. To take a simple, brutal illustration, imagine a deceased person had acquired a building for $900,000 and held it for many years so that at the time of his death the undepreciated capital

cost was $400,000. Suppose the value as at date of death is $800,000. If there are other assets to bring this to the marginal top level, the estate taxes will be $400,000. To meet this obligation the property is sold at the then current value of $800,000. The $400,000 excess over undepreciated capital cost is subject to full income tax almost inevitably at the full maximum rate - which is supposed to be 50%. Out of the $800,000 asset fully 75% would have been absorbed by immediate taxes. We will omit from consideration the additional harsh reality, especially applicable in real estate where there are often long term provisions for payment, where at least certain portions of the tax may be due before funds have been received to pay them.

68. The three-pronged attack on real estate depreciation is expressed as though it had particular reference only to individuals but with a sufficient degree of ambiguity as to imply possible application to corporations only in the real estate business or even to corporations who have some occasional real estate holdings. In such case, if it was intended, corporations with holdings in less economically advantaged areas of the country will be given an extra incentive to obtain terminal losses by selling out their holdings in that particular area where the price is likely to have gone down. We would not like to exaggerate the likely

frequency of such a situation, but any trend adverse to unfavoured regions appears undesirable.

69. A basic principle in the White Paper is the avoidance of retroactivity. It has been intimated by spokesmen for the Department of Finance that the new rules for a separate classification on each piece of property worth over $50,000 should not apply to existing holdings but only to future acquisitions subsequent to implementation of the new law. In view of the investment uncertainties that have been created, if this was intended it should be clearly and authoritatively stated so that public assurances may be available. By the same token, however, an element of retroactivity is necessarily involved in the application of the other rules unless it is intended that the recapturable capital cost allowance for the heirs should only apply to that portion thereof arising subsequent to implementation of the White Paper.

70. Again we are driven to the conclusion that there is a disproportionate attack on real estate investment. There does not seem to be any cogent reason for adoption of any of the modifications of the capital cost allowances. There are many new complexities and distortions which would result that appear to be unfair and unreasonable. In the process they sharply discourage real estate development, contract the potential supply of adequate rental

dwellings for Canadian requirements, dampen the concomitant employment prospects and create uncertainties out of all proportions to the modicum of revenue that may be involved one way or the other. The most active role of the individual investor in rental property is directed precisely to residential dwellings. Any diminution in the market arising by measures which will bar such individual investors will not only affect them but will harm the market for and, therefore, the supply of such property. Rents will rise.

71. If the real estate capital cost proposals in the White Paper are not to be abandoned completely, at very least consideration of their suitability ought to be deferred until the capital cost allowance system is reviewed as a whole. For our part we adhere to the affirmation that the system has "served Canada well". We have not reached such a state of maturity and satiation of the needs of Canadians that we should regard it as unduly encouraging to enterprise and most especially as unduly encouraging to the development of rental dwelling facilities. Any contraction will inevitably increase the cost of lodgings and the cost of living of which it forms so large a part.

Creditable Taxes

72. It is not our intention to enter into the debate on integration of corporate profits and dividend income derived therefrom. However, there is one aspect which concerns us particularly. We hope it will be taken into account in weighing the many different facets involved in an evaluation of this proposal. Capital cost allowances are designed to, and have the effect of, stimulating economic development that might not otherwise occur. Creditable tax for Canadian shareholders will be dependent exclusively upon taxes actually paid. To the extent that such taxes have been deferred because of concentration on depreciable asset developments the resultant degree of creditable tax will initially be reduced. The investor is concerned most with early results. If they are not available there will be no investment.

73. Translated into real estate development terms, the dynamic, aggressive development type corporation which expands its real estate holdings and augments construction employment opportunities will emerge as a very unattractive investment for Canadian shareholders. The very expansive features of its operations may bode well for ultimate future appreciation now to be taxable either at full rates for non-widely held companies or at half rates otherwise. But the proportionate degree

of creditable tax open to Canadian shareholders will bear an inverse ratio to the degree of dynamism of the company's operations and developments.

74. On the other hand the mature slumbering company which has held on to whatever real estate it may own for a long period of time and which embarks upon no new construction whatsoever, or a real estate company which is simply engaged in land speculation without ever becoming interested in any construction or development, will be offering the fullest available degree of creditable taxes to the shareholders. Passive holdings will be encouraged; active investment will be discouraged.

75. As presently projected, this aspect of the creditable tax involves taking away with one hand what has been intentionally granted with the other. It undermines some of the qualities of the capital cost allowance system which has been rightly adjudged by the White Paper to have served Canada so well. It puts the accent on the flow of funds in the wrong places.

76. It will, of course, be apparent that this distortion is not limited to real estate. It would have general application to any activities which other phases of the tax law were designed to encourage. Suppose, for example, at some time in the future some

special tax incentives were to be adopted for regional expansion (such as have been formulated in the past and whether similar or dissimilar in detail thereto), the greater the tax relief or deferral available to the company the more adverse the creditable tax formula becomes for its share-holders. The creditable tax arrangements encourages most that which the rest of the system seek to discourage and vice versa. Presumably this type of factor will be taken into consideration in determining whether to adopt the creditable tax system altogether, but if it is to be adopted some modification should be allowed to take account of depreciation and corresponding items. The creditable tax system may serve some purpose in order to distinguish between Canadian and American taxability of underlying income but not between the depreciable and non-depreciable. It should be corrected accordingly.

77. Finally the creditable tax provision is dependent upon cash or stock dividends within 2½ years. Many trust deeds for bond issues on real estate or otherwise now preclude or limit such distributions for many years into the future. Some provision should be allowed for such contingency.

Non-resident Investment in Real Estate

78. The Canadian real estate market has received significant infusions of foreign capital. Major developments, such as Place Ville Marie or Place Victoria in Montreal, were initiated entirely with foreign capital. Even a project wholly owned by Canadians such as the Toronto-Dominion Centre has, in the main, overwhelmingly been financed by mortgage monies emanating from the United States. Without such non-resident investment, the downtown core of many major Canadian cities might exhibit as they did in certain cases for some decades huge holes in the ground rather than impressive skyscrapers.

79. The White Paper has emphasized that "for the foreseeable future Canada's capital requirements will continue to exceed available domestic savings" (6.8). Without seeking any precise qualitative evaluation, foreign investment in mortgages and real estate ought, from a political and social as well as economic view-point, to be sought as the most desirable features of possible non-resident investment not entailing the kinds of problems about control of our resources by non-residents that apply in other cases. Under such circumstances, measures which may have the effect of impeding the inflow of such capital cannot be accepted with equanimity.

80. <u>Foremost amongst these is the notion that the basic withholding tax on interest should be raised from 15 to 25%. Admittedly the bite is softened by the undertaking that treaty revisions will be negotiated at a continuing 15% rate. The uncertainty thereby created exercises an immediate deterrent on arrangements to obtain mortgages from non-resident sources. Typically these extend over a twenty-year period. Once a hostile trend is indicated, as it already has been, the non-resident institution or investor is inclined immediately to accord Canada a low level of priority.</u>

81. It must always be borne in mind that the 15% withholding tax on interest applies, by virtue of Section 108 of the Income Tax Act, on a gross basis. Accordingly, it cannot avail as a useful credit for the foreign taxes exigible from the non-resident investor. In cases comparable to that of <u>Interprovincial Pipe Lines vs. the Minister of National Revenue</u> 1967 Canada Tax Cases 180 the credit available internally or externally may be nil. In such a situation any increase in the burden of withholding taxes will mean either that the mortgage money from abroad will simply not be available or else that it only can be obtained at higher interest rates so that rent paying Canadians will have to absorb the extra expense entailed. Even apart from real estate the philosophy of the White Paper on non-resident investment

seems to point towards endeavouring to attract greater loan capital and lesser concentration on foreign controlled equity. With this objective we would respectfully submit that any intimation to non-residents that they may be subject to increased withholding taxes on the outward flow of interest, as contrasted with dividends, should be immediately withdrawn.

82. To the extent that non-residents subject to a proposed tax on the gain arising from the sale of their real estate holdings are able to utilize such taxes as a credit against foreign taxes exigible we would find the proposal unobjectionable. To keep within these limits it is necessary to contemplate a capital gains tax rate, as suggested at the outset of our brief, at rates lower than those prevailing in the United Kingdom or the United States. We are not as sanguine as the authors of the White Paper about the ability of Canada to renegotiate tax treaties to obtain this extra source of taxation without countervailing concessions which in the end will cost more to the Canadian Treasury. If it can be done, so much the better. If it cannot, the long term interests of Canada would be better served by absolving foreign investors from a capital gains tax no greater than the tax which would be exigible in their own jurisdiction.

83. In any event, there are some important investments emanating from non-treaty countries. Canada might

take advantage of a Jamaican model for tax modifications so that the non-resident who could establish that the receipt of any proceeds would be subject to tax in his home base would under such circumstances be absolved from a Canadian tax, the prospect of which would have made the individual investment unpalatable. To foreign investors in political unstable countries which are usually less likely to have tax treaties with Canada there has been an important growing tendency to invest in apartment dwellings, low cost housing and office buildings more for reasons of long term hedge against inflation and politcal stability rather than for immediate advantageous economic return. To dry up the source of these funds would bode ill for the welfare of our country and for the availability of dwellings to Canadians and would aggravate the problem of rising rents caused by increased construction costs, high interest rates and the ever prevalent burden of municipal taxes.

Interest Charges

84. One special aspect of interest charges poses a special problem which has been ignored in the White Paper. In countries such as the United States home ownership is deliberately encouraged by fiscal measures allowing for the deductibility of interest charges and taxes. The absence of equivalent measures in Canada makes home ownership and ventures into condominiums, possibilities for which have been foreshadowed by recent changes in various provincial legal systems, less attractive. At least some limited allowance on this score might be considered.

85. In any event, as the rollover provisions imply, a home owner who sells his home in order to purchase an equivalent home elsewhere, whether by reason of job transfers or otherwise, will find his costs of re-acquisition modified by the same inflationary spiral which has occasioned the gain on which he is being taxed. Typically the vendor will receive a portion of the purchase price in the form of an interest bearing mortgage, just as in turn a part of his acquisition costs will be covered by an interest bearing mortgage to which he is subjected. Receipts on the first account are subject to tax while the obligations on the second account is illustrated by William Edward Hopkins vs. Minister of National Revenue, 30 Tax Appeal Board Cases, where the

appellant sold a dwelling on a basis where $10,000 mortgage remained. The interest was fully taxable to him while the corresponding interest charges on his new home were not at all deductible. This disparity should be corrected.

Expenses

86. Before income can be taxed it has to be earned. To earn income it is necessary to incur expenses. The most enterprising and successful businessmen are not content to wait for customers to beat a path to their door. They go out in search of markets. They solicit customers. Sometimes, and this especially applies in real estate sales, many have to be sought in order for a few to be reached. The greater the activity and sometimes the greater the expense the better the results.

87. We are certainly not in favour of any profligate, reckless, self-indulgent expenses to secure a fringe benefit to the participant. There seems to be a complete misunderstanding as to the current status of such expenses under prevailing income tax administration standards. Even a quick glance at recent cases in this field and a simple enquiry will reveal that the most exacting standards are imposed in the application of the rules that an outlay or expense is only deductible if expended "for the purpose of gaining or producing income from property or a business of the taxpayer" (Income Tax Act Section 12(1)(a)), and that "no deduction shall be made in respect of an outlay or expense otherwise deductible except to the extent that the outlay or expense was reasonable in the circumstances" (ibid Section 12(2)). These rules mean what they say and

are so applied. With the burden of proof on the taxpayer and the expertise of the tax administration authorities the abuse sought to be corrected is virtually non-existent. By complete denying "deduction for entertainment expenses... and the cost of dues for membership in social or recreational clubs" (5.9) a greater injustice would be created.

88. The appropriate test which applies today and should apply tomorrow is to determine whether the expense was laid out to earn income and was reasonable. It may be noted that the deduction of the basic maximum rate to 50% should, in itself, reduce any incentive to seek for needless expenses on the score that the Government will be paying the major share thereof.

89. If entertainment expenses are undertaken to promote business then the proposed prohibitions of deductibility will have one of two effects. Either the expenses will be incurred anyway, in which event the parties concerned will be subjected to a higher rate of tax on income by comparison with other taxpayers receiving equivalent income. By the definitions propounded in the White Paper this is manifestly unfair. Alternatively the expenses will not be undertaken, the business will not be promoted and the income will be lost. This is worse. There is a net loss to the taxpayer, to the tax gatherer and to the economy of the country.

90. At a time when it is proposed to allow for deduction of the so-called "nothings", it is curious that a measure should be adopted which would eliminate a "something" even when it is a business expense. A lackadaisical, devil-may-care attitude towards business promotion is certainly not to be encouraged. To a person who is active and successful in the business world it becomes readily apparent that the ratio of rent and other overhead expenses to total volume of business becomes all the greater when steps are not taken to accelerate business promotion.

91. The kind of negative reaction reflected in the White Paper is illustrated in a judgment in Mark McKee vs. Minister of National Revenue 1961 Dominion Tax Cases 239 at page 241: "It was contended that the expenses were unreasonable on the grounds that it was not necessary to make so many trips to Europe and Mr. McKee could have accomplished his object by correspondence. While the method adopted might suit the appellant, such being his way of doing business, it did not follow that expenses so incurred must be acceptable as deductible for taxation purposes". It is interesting to note that even under the current law, questions of this type can be debated and that the Department of Revenue chose to adopt the approach that solicitation by post was an acceptable form of seeking business and that any other alternative which costs money should not be tolerated.

It is equally significant that the presiding officer hearing the case concluded otherwise.

92. Many branches of the Government find it necessary and evidently desirable to incur entertainment expenses, not only in connection with trade promotion but even in relationship to matters where the Government has nothing to sell. It hardly seems good business or good tax policy to favour the rigid type of conclusions propounded in the White Paper.

93. We reiterate that only reasonable expenses should be allowed which is all that is available at the present time. What counts is the results obtainable from the incurring of such expenses. The test should be its business purpose and its intended results. As was aptly observed by Mr. Justice Roxborough in the English case of Bentleys, Stokes & Lowless v. Beeson (33 Tax Cases 491), in dealing with entertainment at lunch in the course of which the party picking up the check enjoyed a "midday gratuitous sustenance":- "The advice could not have been given and the fee could not have been earned if the partner had not attended, and obviously if the partner has got to attend and the client is to be given a lunch, business would not be promoted if the partner should sit by eating and drinking nothing". It would offer a bleak future for the prospects of this country if Canadian businessmen and salesmen were to sit around waiting for the results that might flow from solicitation by post.

Conventions

94. What has been said about expenses applies equally to attendance at conventions. The rule of reason which now applies should not be replaced by an unreasonable prohibition of all convention expenses however desirable and necessary for business they may be. It is our own experience, which we are sure is matched by that of many other organizations, that conventions are valuable adjuncts of business promotion and development yielding material profits - and incidentally greater tax revenue to the Treasury - out of all proportion to the relatively modest costs involved.

95. Horizons are widened for greater markets. Contacts are established for business connections of reciprocal economic advantage throughout the entire country. Changing consumer patterns are better understood and appreciated. Improvements in services available to customers are obtained. The public is better served. Incidentally, but importantly, these assemblies contribute to greater mutual understanding between residents of different regions of Canada.

96. The need for, and importance of, conventions is corroborated by the practice in many non-commercial organizations - such as political parties - of holding conventions. Obviously in such instances they are not

being organized to take advantage of or exploit deductibility of the expenses. They are considered to be vital channels of communication. The same measurement must be applied in the business world. They are organized to improve business and they succeed in their objectives.

97. Again, it must be remembered that the existing law provides adequate sanctions, which are applied by the administrative authorities, against abuse. Only the expenses judged reasonable are considered to be deductible. Clearly this should remain the rule rather than follow the suggestion that even the reasonable expenditures should be disallowed.

Employment Expenses

98. The existing tax system has engendered what the White Paper refers to as a "long standing grievance" in denying to employees the right to deduct expenses reasonably related to the earning of income. (2.10). The Carter Commission recommended that this should be corrected by allowing such deductibility with an option to employees who do not wish to keep records of detailed expenses in amounts equal to 3% of their gross employment income up to a specified maximum.

99. In the interest of eliminating detailed book-keeping the White Paper adopts the last part of the Carter proposal fixing the maximum at $150 per annum, while casting aside the first part and the rationale which prompted it.

100. A striking example of the inadequacy of the limits proposed is afforded by the real estate sales portion of our industry. There is virtually no "walk in trade". Real estate salesmen cater to the whole community and must seek out sources of business in all directions. Where they are on a salary basis as they sometimes are, a limit of $150 is as unrealistic as it is poor business. What-ever might be said about the maximum available for those who opt not to keep any records, surely the salaried employee should be placed in the same category as the

individual or corporate business so that if their records are properly kept and the expenses are reasonably related to the earning of income, they should be fully deductible. The unusual case, which in our industry is not unusual at all, should not be penalised because of the typical situation in other cases.

Income Averaging

101. The White Paper theoretically recognizes the need for averaging but its proposals fall short of this need.

102. The deficiency in the proposed system of averaging is best shown through the use of an example. Let us assume that a taxpayer has taxable income of $3,000 a year in years 1 to 4 and of $8,000 in year 5. Average income for the five year period is $4,000. The following tax results using the combined federal and 28% provincial tax rate schedule in Table 2, page 25 of the White Paper:

Tax without averaging

Tax on $3,000 - $742 x 4 years		$2,968
Tax on $8,000 in year 5		2,355
		$5,323

Tax using proposed system of averaging

Tax on $3,000 - years 1 to 4		$2,968
Tax on $8,000 in year 5 -		
Tax on $4,000 (threshold level - 133 1/3% of $3,000)	$1,024	
Tax on $4,000 (5 x $800 x 30.72)	$1,229	
		$2,253
		$5,221

Tax if $4,000 received in each of 5 years

Tax on $4,000 - $1,024 x 5	$5,120

103. In the above example, the difference in tax arising because the aggregate taxable income of $20,000 realized over a five year period was received in an uneven basis rather than at $4,000 a year is $203 ($5,323 - $5,120). Income averaging as proposed by the White Paper reduces this difference to $101 ($5,221 - $5,120) thus achieving a saving of only 50% of the desired result.

104. We have worked out other examples which show the proposed income averaging system to be less favourable than in the above case; we have also noted situations where it is more favourable but in no situation does the proposed system produce as low a tax as would have resulted if the taxpayer received his income in even amounts over the five year period.

105. The proposed averaging system requires before there is any correction first that the taxpayer's income in a particular year be more than 133 1/3% greater than the average for the previous four years. No relief is given where income declines sharply. The Report of the Royal Commission stated (page 269 of Volume 3) that there is as much, if not more, justification for giving relief when income declines sharply as when it rises sharply.

106. In addition to the above limitation, the White Paper proposes that only the amount above the so-called "threshold level" be eligible for averaging and furthermore that this amount be subject to tax at rates applying above this threshold level. In our example average taxable income in the first four years was \$3,000 in which case the threshold level amounted to \$4,000 (133 1/3% of \$3,000). Of the \$8,000 of taxable income in year five only \$4,000 (being \$8,000 less \$4,000) was subject to averaging. This \$4,000 was taxed at the marginal rates applying in excess of the \$4,000 threshold level. If the taxpayer had received the same total taxable income for the five year period in even amounts (\$4,000 a year) he would never have reached the rate applying above \$4,000.

107. We recognize the need to limit averaging to incomes that fluctuate significantly but suggest that once this condition is met income be truly averaged and not subject to tax at rates applying at a level 133 1/3% above the average income as proposed in the White Paper. Under the White Paper proposal if average taxable income in the first four years is \$18,000 the "threshold" level becomes \$24,000 and any income subject to averaging in the fifth year produces no tax saving since it is still taxed at the top rate reached at \$24,000. (It is not clear if any benefit will be available from general averaging in the early years of the system when the top rate is higher than 51.2%.)

108. We would suggest that the government adopt true averaging along the lines proposed by the Royal Commission on Taxation which the White Paper notes at paragraph 2.54 is similar to that now available for farmers which system the White Paper proposes to continue. We feel that other taxpayers in this country have incomes which fluctuate not unlike that of farmers and should be entitled to the same relief.

Small Business Corporations

109. We find it disturbing to contemplate that, apart from personal tax rate changes, the greatest source of tax change amounting in the fifth year to an increase of $390 million, arises by reducing the special low rate of corporate income tax on the first $35,000 of taxable income. We do not intend to enter into an analysis of the integration proposal, however important it may be, which is linked with this change. However, we feel that this is a subject which we cannot ignore. The overwhelming majority of our corporate members would fall under the category of small corporations. In any event, a great deal of dynamic growth in our economy depends upon the small corporation. Even though only a minority of them may be destined to expand, they contribute a more than proportionate part to the economic growth of Canada. Any measure which radically transforms their tax system ought to be viewed with careful circumspection.

110. It has been suggested by the authors of the White Paper that one of the objections to the current low rate is that it is equally available to the large corporation. This objection rings rather hollow when it is realised that at the supposed 50% maximum rate, the White Paper offers larger corporations an average measure of taxation at least marginally lower than

presently applies. Thus they would be better off if the smaller corporations were taxed at the marginal rates and these rates were brought down a bit to the 50% level. The larger the corporation the more the benefit.

111. The second main argument against relief to the small corporation is directed at the difficulty of distinguishing between the bona fide ones and those that may be deliberately proliferated to take advantage of the low rates. While this has been a problem in the past, it was substantially solved by the changes in the law introduced in 1963 and by the demanding administrative techniques which have been devised and are currently applied. In short, surgery is proposed after the patient has been cured.

112. If the dual rate is abolished, at least some alternative relief should be afforded to small corporations. The Carter Commission recommended more generous capital cost allowances. Incidentally implicit in this recommendation is the recognition that the problem of limiting the small corporation within suitable confines is a soluble one in any event. This type of correction is unduly narrow because it fails to take account of the growing importance of service and other corporations where depreciable assets are not of great importance. Perhaps consideration might be given to something akin to the obverse of the refundable

tax which has been resorted to exceptionally at different times in our tax history. These corporations might be allowed an interest free defined time period during which some portion of the tax otherwise payable is deferred. The net result would not be very substantially different from that which applies at the present time, but it might be more easily fitted into the integration system. At any rate, it would be a regressive step if small corporations which in the past have been generative of so much economic activity should be hampered because the framers of tax reform measures found it inconvenient to fit more of them into a universal mould.

CAREB SPECIAL STUDY COMMITTEE ON
PROPOSALS FOR TAX REFORM

F. Norman McFarlane Chairman	President, 1970 CAREB	President, F. Norman McFarlane Ottawa, Ont.
Harold Dueck	Vice-President CAREB	President, Fairhaven Realty, Winnipeg, Man.
H.P. Bell-Irving	Vice-President CAREB	President, Bell-Irving Realty Ltd. Vancouver, B.C.
J.T. Blair Jackson	Research Director, CAREB	Toronto, Ont.
Philip A. Buttar	Past President, Alberta Real Estate Association	Manager, Weber Bros. Realty Ltd. Edmonton, Alta.
Thomas J. Byrne	Regional Vice- President, CAREB for Newfoundland & Labrador	President, Byrne's Real Estate Ltd. Saint John's, Nfld.
Albert Fish	Past President, Ontario Association of Real Estate Boards	President, Albert Fish Real Estate Ltd Guelph, Ont.
Col. J.A. Hutchins	General Counsel & Dir. of Information Montreal Real Estate Board	Montreal, Que.
B.R.M. Magee	Past President, Toronto Real Estate Board	Chairman, A.E. LePage Limited, Toronto, Ont.

David M. Lunney	Regional Vice-President, CAREB for New Brunswick & Prince Edward Island	President, David M. Lunney & Assoc. St. John, N.B.
Kenneth A. Stephen	Treasurer, CAREB	Treasurer, A.E. LePage Limited, Toronto, Ont.
<u>CONSULTANT</u>:-	Robert J. Dart, Partner, Price Waterhouse & Co.	Toronto, Ont.
<u>COUNSEL</u>:-	Philip Vineberg, Q.C. Phillips, Vineberg, Goodman, Phillips & Rothman	Montreal, Que.

APPENDIX "B"

SUBMISSION

To The

Senate Committee

on Banking, Trade

and Commerce

on

The White Paper on Tax Reform

April 30, 1970

CANADIAN CONSTRUCTION ASSOCIATION

CONSTRUCTION HOUSE, 151 O'CONNOR STREET, OTTAWA 4, CANADA

CANADIAN CONSTRUCTION ASSOCIATION

CONSTRUCTION HOUSE, 151 O'CONNOR ST.,
OTTAWA 4, CANADA
AREA CODE 613/236-9455

Hon. Salter Hayden, Chairman,
and Members of the Banking,
Trade & Commerce Committee,
The Senate,
Ottawa 4, Canada.

April 30, 1970.

Honourable Senators:

Re: White Paper on Tax Reform

The Canadian Construction Association very much appreciates the opportunity of presenting its views on those proposals in the White Paper which have particular significance to the construction industry.

It will be recalled that when the Association submitted a brief to your Committee last year with regard to Bill C-165, it was strongly urged that the Government's proposals to amend the schedule of estate taxes and the gift tax legislation be deferred until they could be considered in concert with its other tax reform proposals in the White Paper.

Whereas the latter deals only with Income Tax matters, the Association again strongly contends that it is impossible to exclude Estate and Gift Taxes from the present review, inasmuch as they are so directly related.

Similarly, although the White Paper states that Sales Tax reform must await the execution of Income Tax reform, the Association wishes to stress that the industry's long-standing recommendations concerning the Federal sales tax do not involve "reform" and that decisions by the Government in this area should not be further delayed.

Last year the Association's brief on Bill C-165 stressed that construction companies are typically family or closely-held firms, incorporated, short on liquid assets and dependent upon their own resources for capital expansion and business growth. These characteristics and the mobility of its labour force have an equally vital bearing on the White Paper's proposals.

It is accordingly respectfully requested that equal attention be given to the sections of this brief dealing with the unique nature of construction operations and companies, as to the sections containing the Association's general observations and specific recommendations on the White Paper's proposals and other taxation matters.

All of which is respectfully submitted,

INDEX

1. SUMMARY

The CCA is an industry-wide and nation-wide Association representing construction industry employers. It submitted a detailed brief to the Royal Commission on Taxation and was gratified that the bulk of its recommendations were specifically supported in the Royal Commission's Report. The study of the White Paper on Tax Reform has been a major project in the CCA. This brief contains a widespread consensus of the industry's views on White Paper proposals having particular application to its operations.

The Construction Industry and its Special Characteristics

The value of the 1970 construction program is estimated to be upwards of $14 billion. Construction is Canada's largest single industry by a large margin. Within the program there is great variety in terms of size and nature of construction project and company alike. Construction operations are subject to many variables -- economic, physical, financial etc. -- out of the industry's control. Construction companies are virtually all family or closely-held corporations. This has proven to be especially appropriate for the high-risk and highly-specialized construction industry.

Other characteristics of construction companies are that they are commonly short on liquid assets and largely dependent upon their own resources for growth. The construction labour force is extremely mobile. The above unique combination of aspects of the construction industry have a vital bearing on the White Paper proposals and should be borne fully in mind when considering the brief and in formulating tax policies.

General Observations on White Paper Proposals

(i) Whereas the White Paper deals only with Income Tax matters, Estate and Gift Taxes must be included in their consideration. Similarly, Excise Tax revisions should not be further delayed.

(ii) The proposals to tax the middle income group and small incorporated firms more heavily will tend to impede business enterprise and increase present regional disparities.

(iii) Due stress must be placed in Canada on the need to accumulate or to attract funds for industrial expansion and other capital investment required to support improved standards of living.

(iv) Canadian tax rates should not get out of line with those of the United States of America.

Recommendations

(i) Estate and Gift Taxes. These should be repealed; the proposal to tax capital gains makes this all the more desirable.

(ii) Rates of Corporation Income Tax. The split rate of corporate tax should be retained. Alternatively, a company should have the option of deferring payment of half of the tax on the first $50,000 of income until dividends are distributed.

(iii) Time Limit for Dividend Distribution. The proposal should be withdrawn that there be a 2½ -year time limit on the payment of dividends by corporations, in order that shareholders may obtain a tax credit for corporation tax paid.

(iv) Taxation of Capital Gains. If a capital gains tax is to be levied, it should only be imposed at the time the gain is realized; not exceed existing U.S. rates of tax; and be applied at the same rate to gains made on shares of either closely-held or widely-held corporations.

(v) Taxation of Middle Income Group. The proposal to increase the taxes paid by those receiving from $12,000 to $25,000 annually should be reconsidered, particularly in view of the increased Canada - U.S.A. after-tax differential that would result. The construction labour force is very mobile and many construction tradesmen, equipment operators and supervisory personnel are in this income group.

(vi) Capital Cost Allowances. The White Paper proposal that a separate classification be established for each rental building valued at $50,000 or more is accepted but real estate developers should be allowed to offset losses on one project against profits on another. Also, the Government should present its plans for capital cost allowance rates during the present review. In this regard, the CCA lists specific proposals for increases in the rates allowed for structures, certain equipment, and tools.

(vii) Reporting of Income. The Income Tax Act should afford legal status to the completed contract method of reporting income and include special provisions to accommodate holdback arrangements and other factors impeding the flow of funds to contractors.

(viii) Carry-back and Carry-forward of Losses. Companies should have the right to carry losses back for a period of five years and forward indefinitely.

(ix) Consolidated Tax Returns. Related corporations should be allowed to file consolidated income tax returns.

(x) Association Convention Expenses and Investment Income. The White Paper proposals to disallow as a business expense those incurred in attending conventions and to tax associations' investment income should be withdrawn, inasmuch as they would seriously reduce the effectiveness of non-profit associations.

(xi) Goodwill. The percentage of the value received for goodwill to be brought into income by the recipient should be brought into line with the capital cost allowances granted to the purchasers. The White Paper proposal to tax 40% of the value received for goodwill in the first year after implementation may amount to onerous retroactive taxation.

(xii) Advance Rulings. Prior rulings should be available on resultant tax effects of contemplated business acquisitions, mergers, etc.

(xiii) Excise Tax Revisions. Action should not be further delayed on the CCA's long-standing recommendations concerning sales tax exemptions for the industry's production equipment and pollution control equipment, the restoration of previous exemptions for building materials, etc. Such action would conform to general or previous policy rather than constitute "reform".

2. INTRODUCTION

(i) The Canadian Construction Association -- Membership and Operating Procedures.

The CCA was founded in Ottawa in 1918 as an industry-wide and nation-wide association of construction employers. Its membership is comprised of over 2,750 firms and over 100 member associations (Appendix "A"). The latter in turn have a combined membership in excess of 12,000 firms. The bulk of the contract construction program in Canada is carried out by members of the CCA and its Affiliates.

The Association's membership includes general building contractors; road builders and heavy construction firms; trade or specialty contractors, including manufacturing contractors; manufacturers and suppliers of construction materials and equipment; primary producers; and firms providing professional and specialist services. Its 24-member Board of Directors includes ten Provincial Vice-Presidents, appointed by CCA Provincial Affiliates; four Section Chairmen, representing the main groups of the Association's membership; and a Liaison Director representing the National House Builders' Association.

The CCA is proud of its reputation for submitting recommendations that are representative, reasoned and responsible. In the taxation field the Association presented a detailed brief to the Royal Commission on Taxation and was gratified that the bulk of its recommendations were specifically supported in the Royal Commission's Report. Briefs on taxation have also been submitted on a regular basis to the Federal Government for many years and the CCA's annual submission to the Federal Cabinet always contains an important section dealing with Fiscal Policies.

Taxation matters are dealt with in the CCA by a Standing Committee. In addition to members drawn from individual member firms, the Committee's personnel is comprised of representatives appointed by member associations. In preparing for this brief the Committee not only held several of its own meetings but also distributed to the entire CCA membership a synopsis of selected portions of the White Paper and a detailed questionnaire; requested members to consult with their own tax advisors; and convened a special Forum during the CCA Convention at which its draft recommendations were discussed. The CCA Board of Directors also reviewed the draft material in detail on two occasions. A summary of the proposed recommendations was sent to the entire membership and a copy of the draft brief was sent to all member associations, CCA officers and members of the Taxation Committee for comment.

It is believed that the above-mentioned procedures ensure that the brief contains a widespread consensus of the construction industry's views on the White Paper's proposals which have particular application to its operations and therefore deserves your Committee's full consideration. (Other White Paper proposals not dealt with here would of course affect individual firms in the construction industry or have a general impact not peculiar to its members).

(ii) The Size and Nature of the Construction Program

Construction is a leading economic activity and generator of employment in every region of the country. The value of the construction program to be executed this year is estimated by the Federal Government to be in excess of $13.9 billion. This makes construction Canada's largest single industry by a substantial margin.

Construction outlays have on average accounted for roughly one-fifth of the Gross National Product. They provide on-site jobs to the year-round equivalent of some 590,000 Canadians and to an even larger number engaged in the manufacturing, transporting and merchandising of construction materials, components and equipment.

The contents of the construction program are extremely varied and specialized in nature. 40% of the total is comprised of engineering construction work and 60% of building construction. Roughly half of the latter portion is residential construction. Within these broad categories the various main types of construction project range from subways to sky-scrapers, from individual dwellings to integrated community developments, from dams to dredging, from pipelines to petrochemical plants, from highways to hospitals, from schools to steel mills, from nuclear plants to northern townsites, and from sewage systems to shopping centres.

Much of the construction program is located in or near the main metropolitan areas. On the other hand, many of the major projects are built far from the main centres of population and involve large-scale movements of men, materials and machinery to the job-sites.

The Dominion Bureau of Statistics estimates that over 80% of the construction program is carried out by contractors. The balance is executed by Owners ranging from those with sizeable construction forces to the "do-it-yourself" individual. The trend is increasing towards the use of the Contract Method. Even where prime contractors are not used, the materials, component installations and equipment are supplied by private firms. Moreover, equipment may be rented from private firms and some of the construction work let to specialty contractors.

In most cases projects are initiated and financed by other parties than those building them. Over 40% of the construction program, for example, is financed by governments at the various levels and much of the privately-financed projects are facilitated by government loans, incentives or policies. The size, scope and complexity of individual construction projects have greatly increased in recent years. On the other hand, the great majority of the projects in the construction program are relatively small or medium-sized. About 20% of the total program is related to repair work.

3. VARIABLES AFFECTING CONSTRUCTION OPERATIONS

The construction program is subject to many important variables which greatly affect its size and the financial outcome of individual contracts. These variables, most of which are out of the industry's control, make construction a high-risk venture.

The "construction cycle" has traditionally experienced wider swings than the business cycle. Moreover, within the overall construction program there are frequently substantial fluctuations from year to year in the volume of work available to the various sections of the industry and in the various sections of the country.

This instability in the size of the construction program is a basic fact of life for construction firms. These fluctuations have been further accentuated by the construction programs of the senior governments and the latter's tendency to use the construction program as a medium to stimulate or slow down the overall level of economic activity. The introduction or cancellation of programs and changes in monetary policy often lead to abrupt changes in the level of construction activity, especially in the fields of housing and public works.

Moreover, the instability of the construction program has been cited in turn as the main factor explaining the relative lack of stability in the field of construction labour relations. Work stoppages, jurisdictional disputes, excessive settlements etc. have been far more widespread in the construction industry in terms of the numbers affected than in other major industries and have a most serious effect on the profit or loss outcome of a contract.

The high risk nature of construction operations has placed stringent limitations on the availability of funds to firms in the industry through the public sale of stocks or bonds. This in turn has meant that construction companies have had to rely heavily on the banks, on trade

credit and on their own earnings to finance their operations and business expansion. Similarly, it has made construction firms especially vulnerable to arbitrary restrictions on the amount of bank credit following the imposition of monetary restraints.

Moreover, it should be noted that construction companies experience unique cash flow problems due to mechanics' lien legislation and other payment hold-back requirements. Bankruptcies can and do cause chain reactions affecting other construction industry firms which are either creditors or which are faced with the added expenses of delays and those related to the fulfilling of sub-contracts or supply orders originally awarded to the firm going bankrupt.

Construction companies require financial resources to tender on work in the first place. For instance, they may have to post a certified cheque with their tender which is held by the Owner as security until the completion of the contract. Alternatively, the contractor may be required to furnish a surety bond. A company's "bonding limit" is directly related to its financial situation. A decrease in its liquid balance, for example, will lead to a decrease in its bondability and the amount of work it can tender.

The vast majority of construction work is executed on a firm price contract basis. These contracts often cover periods of a year or two or even longer, during which time construction costs may be materially affected by changes in the cost of labour, materials, equipment and overhead expenses and by new legislation.

In addition, the execution of construction work -- and its cost -- is subject to variables related to weather conditions and to soil conditions. Scheduling is of vital importance. Costly delays may be incurred due to slow decisions on design matters and in the preparation of design changes. Transportation facilities may only be available at

certain times of the year for remote location projects. Delays out of the contractor's control may mean that products required for a project miss a production run. Contractors may well be subject to onerous penalties if completion dates are not met.

Contract provisions stipulated by some owners and legal decisions can add greatly to the contractor's risks. These include responsibility for the adequacy of designs prepared by other parties, the lack of recourse against the supervising engineer's or architect's decisions, the insertion of onerous "hold harmless" clauses by the Owner, and the denial of compensation to contractors for extra costs due to inaccurate information on sub-surface conditions, changes in quantities, delays in payment etc.

The above incomplete list of variables and business risks is not intended to paint a picture of gloom but rather to illustrate that construction firms have out-of-the ordinary financing needs, that tendered amounts are but estimates, and that a potential profit picture can and does change rapidly. This unique combination of factors causes special problems and conditions in the construction industry that should be recognized in the formulation of tax policy.

4. MAKE-UP OF THE CONSTRUCTION INDUSTRY

(i) Companies

The family corporation or one which is "closely-held" appears to have characteristics that are especially appropriate for the construction industry. All but a handful of the general contractor, trade or specialty contractor, equipment distributor and builders' supply firms are in this category. Even some of those which are publicly listed are still controlled and operated by the founding family or company principals. (Firms manufacturing construction products are the usual mixture of widely-held and closely-held firms).

This situation may be explained in large measure by the facts that entry into the industry is easy, that the limited liability status available through incorporation is especially important to construction companies and that the majority are small or medium-sized firms. But that is not the whole story.

As has been noted above, construction is a high risk business with many hazards. Capital investment in construction equipment is often heavy. Builders and developers initiating their own projects have large amounts of capital tied up in land and buildings. Competition throughout the industry for contracts and sales is exceedingly keen. These factors are such that a high degree of personal financial stake and involvement in the management of companies in the construction industry are particularly important elements in their success.

A closely-related characteristic of the construction industry is that of specialization. Prime contractors tend to specialize in certain types of construction work and in the provision of services. For example, their co-ordination of operations on a job-site is a specialized function in itself. The high degree of specialization in the industry is also reflected by the

abundant use of sub-contractors and sub-sub-contractors and even of sub-sub-sub-contractors. This specialization and the fact that those supervising these specialized operations have a personal incentive to see that the work is carried out as quickly and as economically as possible have been cited as the main reasons why construction work is executed faster and with a smaller on-site labour force in North America than, say, in Europe.

It is noteworthy that many large manufacturing concerns, as a matter of policy, select family or closely-held firms to act as their distributors. This is done in order to obtain the same qualities of aggressive, personal management by people with a direct financial stake in the success of their regional representation.

It should also be stressed that many of the firms in the construction industry have developed over the years to the point that they are now multi-million dollar businesses. A high proportion of them are second or third generation firms. To survive and expand over such a lengthy period in the construction industry is testimony enough of the managerial ability and tenacity of the principals concerned. The Association strongly contends that, whereas the Carter Commission commented that there was nothing special about family-owned firms that necessarily made them more efficient than others, family firms and other closely-held corporations do in practice appear to be especially well suited to carry out most construction operations.

In summary, it is urged that the special characteristics of firms engaged in Canada's largest industry be taken into full account in the consideration of new tax proposals. The construction industry, apart from its manufacturing sector, is comprised very largely of incorporated family or closely-held firms. They require relatively large amounts of money for their operation and expansion, and in this regard have extremely limited scope in

raising funds through the sale of stocks and bonds. Construction volumes and company profits are subject to widespread fluctuations and individual projects to many variables and cost factors out of the company's control. Competition is keen and the casualty rate is heavy.

Canada is dependent upon the construction industry for the provision of the physical means for the nation's economic development and higher standards of living. Family firms and other closely-held companies are particularly appropriate for the high-risk construction industry because of the involvement of their owners in the management and supervision of specialized construction operations. Construction company owners generally do not have widespread investment other than in their own companies.

(ii) Construction Personnel

Construction employers are naturally also concerned about the effect of tax reforms on their employees. Here again, there are distinctive characteristics in the construction labour force. The most significant of these is that of mobility. It is commonplace for construction tradesmen and equipment operators not only to work on different job-sites (possibly in quite widespread locations) each year but also for different employers. The absence of a continuing employer-employee relationship in one location for most of the construction labour force, together with employment opportunities in the main centres of construction activity, both in Canada and abroad, combines to produce an above-average tendency for construction workers to move to where they can increase their take-home pay. Many of the skilled tradesmen and equipment operators are in the middle income group.

The same situation also exists with respect to foremen, superintendents, project engineers, administrative personnel etc., although employers tend to keep on their key people even if they do not have current assignments for them. The fact that there is a

shortage of trained construction personnel in the U.S.A.; that wages and salaries are in general appreciably higher there and taxes lower; and that most in these categories are past U.S. draft age are a continuing source of concern that a large number of key employees may emigrate if the after-tax income differential widens.

5. GENERAL OBSERVATIONS ONWHITE PAPER ON TAX REFORM

Last year the Association expressed on behalf of the construction industry very grave concern over some of the provisions of Bill C-165 dealing with estate and gift taxes with resepect to their effect on the ability of family construction firms to continue operations on their passing from one generation to the next. This in turn would tend to encourage sell-outs of existing firms and discourage company expansions or the formation of new ones.

It was conceded that estate taxes placed a special burden on family firms and on estates in which the major assets are not liquid. (Both factors are the norm in the construction industry. The two main assets of a contracting firm are know-how and equipment. Neither are liquid in nature and a firm may well have considerable indebtedness to boot).

This year the Government's proposals have been introduced in White Paper rather than in Bill form, have been referred to Parliamentary Committees for study and in general have been designated for public debate and comment. This procedure is warmly welcomed by the Association and it is hoped that full consideration will be given to the impact of the White Paper's tax reform proposals on:

(i) the level of construction activity - i.e. on the capital investment decisions of those initiating construction projects

(ii) the future operations and efficiency of construction firms -- i.e. very largely incorporated family firms or closely-held companies requiring self-generated capital for expansion

(iii) the very mobile construction labour force -- i.e. in terms of income after taxes available in different jurisdictions to managerial, supervisory and skilled trade personnel.

Before submitting its specific recommendations, the Association would like at the outset to make some general observations on the Federal Government's proposals for tax reform:

Firstly, whereas the White Paper deals only with Income Tax matters, it is strongly contended that it is impossible to exclude from the present review the matter of Estate and Gift Taxes, inasmuch as they are so directly related. Similarly, although the White Paper states that Sales Tax reform must await the execution of Income Tax reform, the Association wishes to stress that the industry's long-standing recommendations concerning the Excise Tax Act do not involve "reform" and that decisions should not be further deferred by the Government in this area.

Secondly, some of the proposals in the White Paper are seen as a further threat to the competitive enterprise system. For instance, the proposals that the middle income group and small incorporated businesses both be taxed more heavily will, if implemented, combine to reduce the feasibility of establishing or expanding a business and the incentive to do so. Moreover, such factors would tend to have a greater adverse effect in the under-developed areas and thereby increase the present regional disparities.

Thirdly, whereas the White Paper expressed the desirability of achieving greater equity in tax matters without sacrificing economic development, it is stressed that in a young nation such as ours due emphasis must be placed on the accumulation or attraction of funds for industrial expansion and other capital investment needed to support a comprehensive program of social measures.

Fourthly, the Association has long urged that Canadian taxes not get out of line with those of other countries, especially the United States of America. In this regard, it will be noted that the new schedule of estate taxes introduced last year in Canada arrives at higher rates of tax much more quickly than is the case in the U.S.A. The Government's proposed first venture with respect to a capital gains tax is similarly more onerous than the one exacted in the United States. These and other tax proposals promise to widen the tax differential between the two countries which exists in a number of areas.

It would be appreciated if these factors, together with the unique features of the construction industry's composition and operations, are borne in mind in the consideration of the ensuing comments and recommendations.

6. RECOMMENDATIONS

(i) Repeal of Estate and Gift Taxes

The submissions made by the CCA to the Minister of Finance and the Federal Cabinet and to your Committee (Appendix "B") with regard to Bill C-165, which amended both the estate tax and gift tax legislation, urged that action in these fields be postponed and included in the White Paper on Tax Reform. It is now obvious that the Association's fears were justified and that it is grossly unfair and unrealistic to incur the combined impact of revised income tax laws and the new estate and gift taxes.

If the proposal to tax capital gains at the full rate is incorporated into law, it then becomes essential to abolish or at least greatly modify the gift and estate tax laws so as to allow closely-held (family) corporations to survive from one generation to the other. As stated in Section 4 of this brief, construction firms are comprised mainly of family-owned or closely-held corporations and the latter are particularly suited to construction operations. The continuation of such enterprises should therefore be encouraged rather than discouraged.

Despite the suggestion that capital gains tax need not be paid at the time of death, it is obvious that any forced sale of assets required to meet the demand for estate taxes will in many cases run into crippling income tax imposts on the capital gains realized. This is particularly true in the case where retroactive tax is levied on goodwill as provided in paragraph 5.8 of the White Paper. The total impost reaches such high proportions that it amounts to confiscation by the Government and must be recognized as such. If it is the Government's policy to impose confiscatory levies, then it should be plainly stated by it that this is so. The following examples illustrate the problem:

Taxable value of estate	$ 300,000	$1,000,000
Estate tax	89,200	439,200
Net estate	$ 210,800	$ 560,800
Value of shares of closely-held corporation included in estate	$ 200,000	$ 800,000
Cost basis thereof to estate or beneficiary -		
Cost to deceased	$ 10,000	$ 100,000
Plus estate tax applicable to the gain	56,500	307,400
	$ 66,500	$ 407,400
Gain on disposal	$ 133,500	$ 392,600
Tax on gain at 50% rate	$ 66,750	$ 196,300
Net assets available to estate or beneficiary	$144,050	$ 364,500
Percentage of assets remaining	48%	36%

(Source: Clarkson, Gordon & Co. report)

The estate tax revenue to the Federal Government is not a significant factor with regard to total revenues. The latest figures show $112,600,000 annual receipts from estate tax compared to a total revenue of $8,986,300,000, being slightly more than 1 per cent of the total. A high percentage of estate taxes collected is transmitted to the Provincial Governments. Two provinces have already adopted a policy to refund their share of this money to the taxpayer.

It is incumbent upon the Government to take action to avoid confiscation by tax while at the same time to restore equilibrium by repealing the estate and gift taxes.

(ii) Rates of Corporation Income Tax

While endorsing in principle the proposal of the Government to integrate corporate and personal income tax, the Association does not accept the statement in the White Paper that it is necessary to tax all corporations at the proposed 50% rate on all income.

It is obvious from reading the White Paper and reviewing statements by the Minister of Finance and other members of the Government that there is a basic difference in philosophy with respect to retained earnings between them and members of the construction industry.

The Government apparently feels that retained earnings are a vehicle whereby certain taxpayers can accumulate funds at the lower corporate tax rate of 21 per cent and spend much of their time devising schemes to extricate these funds without additional payment of tax. This may be so in some cases, but in the construction industry, retained earnings are for the most part regarded as a prime source of working capital.

The risky nature of our industry's operations precludes new ventures and, at certain times and in many cases, mature enterprises from making use of the normal sources of funds for working capital requirements. It would be impossible, for example, to float a stock or bond issue for a new construction company. The banks, due to provincial mechanics' lien legislation and other peculiarities of the industry, are restrictive in funding construction companies. The working capital that is generated by the lower rate of tax on the first $35,000 of income is accordingly of great importance to firms in the construction industry and the retention of the present split rate of corporation income tax is strongly recommended.

The Association recognizes the problems of incorporating split corporate rates of income tax into an integration scheme. It therefore strongly urges the Government to consider an alternative proposal that a corporation be allowed the option of deferring 50 per cent of the full tax on the first $50,000 of income until dividends have been distributed. It is believed that this would provide for the working capital needs of small companies, while at the same time ensuring that there is no loophole for tax evasion.

	WHITE PAPER		C.C.A. PROPOSAL	
	Company "A"	Company "B"	Company "A"	Company "B"
Taxable Income	$ 50,000	$ 100,000	$ 50,000	$ 100,000
Proposed Tax	25,000	50,000	12,500	37,500
Deferred Tax	-	-	12,500	12,500
Amount of funds for working capital	25,000	50,000	37,500	62,500

It can be seen from the above-noted example that both Company "A" and Company "B" will have an additional $12,500 working capital. This is most significant when it is considered that the rate of expansion of a construction company is limited effectively by its capacity to obtain bonds which are required for most construction contracts. These bonds include:

(a) Bid Bonds

These guarantee that a contractor will enter into a contract at the price he submitted in his bid, or be penalized.

(b) Performance Bonds

These bonds ensure that the contract will be performed in accordance with the specifications.

(c) Labour and Material Payment Bonds

These protect the owner against losses arising from the contractor's default in payment to direct sub-contractors or suppliers for work done with respect to the contract.

As a rule of thumb, bonding companies will not usually bond a contractor whose net quick asset position is less than 10% of total contracts in progress. The net quick assets are defined as being current assets minus current liabilities. It can therefore be seen in the examples above that in each case the contractor's bonding capacity is increased by $125,000. Therefore, not only does he have working capital to cover overhead expenses and holdbacks, but his ability to tender on more work is enhanced.

The financing of holdbacks, which is usually an amount of 15 per cent retained by the owner from his periodic payments for work that has been approved until the satisfactory completion of the work, places a peculiar financial strain on the contractor which gives rise to a unique requirement for working capital.

It is submitted that the CCA proposal would not only assist the contractors in generating working capital for their own use but at the same time would ensure that all dividends received by individual shareholders can be treated in the same manner for integration purposes. For example, in the foregoing case, a dividend distribution would produce the following results (assuming that dividends are distributed in the second year):

	WHITE PAPER		C.C.A. PROPOSAL	
	Company "A"	Company "B"	Company "A"	Company "B"
Earned surplus	$ 25,000	$ 50,000	$ 25,000	$ 50,000
Deferred tax	--	--	12,500	12,500
Amount declared for distribution	25,000	50,000	25,000	50,000
Deferred tax payable prior to distribution	--	--	(33 1/3% of $25,000) = 8,333.33	12,500
Amount distributed as dividends	25,000	50,000	16,667.67	37,500
Balance in deferred tax account	--	--	4,167.67	--

The computing and payment of deferred tax would not be difficult from an accounting point of view as long as it is stipulated that any distribution of funds is subject to deferred taxes payable prior to distribution.

It has been conceded by the Minister of Finance in his appearance before your Committee that some form of income tax incentive, such as that proposed in the Royal Commission on Taxation report, should be granted for new corporations. Our concern with the Royal Commission proposal, which would allow accelerated depreciation for new corporations, is that it would not benefit those firms which have a relatively small investment in depreciable assets compared to capital intensive companies. The proposal outlined above would be more equitable, although we could envisage a situation where a taxpayer could take the choice between an accelerated depreciation allowance or a deferred tax payment, if the former is attractive to your Committee.

(iii) Time Limit for Dividend Distribution by Corporations

The White Paper proposed that there be a $2\frac{1}{2}$ -year time limit on the payment of dividends by corporations in order that individual shareholders may obtain an income tax credit for corporation income tax paid. This is most undesirable for firms which need to generate funds internally for expansion. The proposal should be deleted.

The continued emphasis in the White Paper on the distribution of earnings rather than on their retention as working capital is difficult to understand from the point of view of the construction industry where working capital is the paramount requirement. Surely the fact that a particular shareholder obtains a tax credit on taxes that were paid on earnings when a different shareholder was involved indicates a weakness in the integration system and should not force payment of dividends, either in the form of cash or stock, to the detriment of the corporation. If the Government is concerned over the possible transfers of shares between a high tax-rate shareholder and a low-rate individual made to obtain additional tax credit regulations should be adopted to prevent them, rather than to require firms to distribute badly-needed working capital.

If the CCA's proposals for deferred tax are accepted as an alternative to the split rate corporate tax, an automatic equalization would of course occur. On the one hand, tax credits would be accumulating to the individual taxpayer, while at the same time, tax credit would be accumulating to the Government from the corporation involved. Therefore, any payment from surplus would first be required to account for the tax deferred on the dollars distributed which would then of course offset the impact on the Treasury of any tax credits claimed by individual shareholders.

(iv) Taxation of Capital Gains

a) Combined Impact of Estate and Gift Taxes

As stated in Recommendation (i), the Association is deeply concerned over the combined impact of capital gains tax and estate and gift taxes on the ability of a closely-held construction company to survive from one generation to the next. It is our view that estate taxes are already a tax on capital gains and full allowance should be made for this fact. The proposal to transfer assets to heirs at the acquisition value of the testator will only be effective on those cases where enough liquid assets are available to pay the estate taxes. A sale of shares or other assets cannot be regulated according to need, as there is no viable market for minority holdings in closely-held construction companies. To raise the cash, sellouts are often required, and the proposed tax on capital gains would be devastating.

The Department of Finance paper submitted to your Committee by the Minister of Finance on March 10, 1970 regarding the periodic revaluation of widely-held shares indicates that a seriously-considered alternative to the perplexing five-year deeming of tax on unrealized gains arising from such shares would be the deemed realization of capital gains at the time of death. This compounds the concern in our industry that closely-held corporations would encompass "closely-controlled, widely-held companies".

It is essential, therefore, that relief be granted in such instances, either by the removal of estate taxes or by meaningful reductions in the tax on capital gains. For example, the exemption granted to spouses from estate taxes could be extended to capital gains, i.e. rather than deeming realization of capital gains, the spouse could have the option of transferring the shares at the purchase value of the deceased.

b) Deterring Effect on "Going Public"

In addition to the combined imposts noted above, the Association is also concerned with the deterring effect of the capital gains tax proposals on the closely-held corporations which, for sound business reasons, are considering offering their shares on the public exchanges.

The capital gains tax that could be exigible at that time could easily pose a serious stumbling-block to the expansion program. If this stumbling-block can be overcome and if the owners wish to retain control of the enterprise, which is the normal practice in the construction industry, they must concern themselves with the five-year payment of tax on unrealized gains. Such tax could cause the sale of stocks concerned to the extent that control would slip from the founding group. Faced with these very real tax liabilities and possible loss of control, companies which have good and proper reasons for offering public shareholdings will be inhibited from doing so.

It is submitted that such would be contrary to the economic good of both the construction industry and of Canada as a whole. The consequences of the foregoing results of the White Paper proposals would be that closely-held corporations will tend to be sold "en bloc" and the established procedure of owners selling an interest to employees over a period of time will tend to disappear. The larger closely-held corporations will be saleable only to other larger Canadian corporations or foreign interests, which would in time result in a concentration of power and control of the industry in a few major corporations.

The Association would like to comment on the specific modifications that have been suggested to the Department of Finance, as reported to your Committee by the Minister of Finance in his submission of March 10, 1970:

1. "Some have suggested time to pay the tax, either with or without interest."

   This suggestion has merit and would be consistent with the provisions incorporated in the recently amended estate tax and gift tax law.

2. " Others have suggested the governments accept some of the shares in payment".

   This suggestion may have merit, but would bring the Government into various areas where it is not already involved and could put it in the untenable position of being a shareholder on the one side and a tax collector on the other, with all the schizophrenic ramifications that would pertain.

3. "Still others have suggested that controlling blocks of shares be excused, or that any taxpayer be subject to revaluation on no more than 5 per cent of the issued shares of any corporation - any additional holding would be excused from revaluation."

   It is felt that suggestions #3 and #4 are not mutually exclusive. If the share were not exempted from revaluation in accordance with suggestion #4, then certainly suggestion #3 has considerable merit.

4. " In a somewhat similar vein, some have suggested that a taxpayer not be required to revalue shares in a widely-held corporation if he acquired the shares while the corporation was a closely-held corporation."

   The Association wholeheartedly supports this suggestion. It would certainly remove one of the major stumbling-blocks of the problem noted above vis-a-vis the ability of closely-held construction companies to "go public".

5. " A different type of suggestion, either in addition to or in substitution for the others is that periodic revaluation be extended to closely-held corporations so as to remove the distinction - for example, the Government of Ontario suggested that all other assets be revalued every 15 years, and others have suggested that all corporations over a certain size be classified as widely-held so as to remove the distinction between large corporations."

   The Association is strongly opposed to suggestion #5 and maintains that the guiding principle of taxation should be to minimize the tax on unrealized gains on any type of asset.

"In addition to these modification, it has been suggested that the proposal be dropped entirely."

The concluding proposal, that periodic revaluations be dropped entirely, has much merit and, if adopted, it would preclude the necessity of considering the other proposals.

c) Capital Gains Tax Rate

The Association is concerned that the proposal to tax capital gains at the full personal rate of tax (other than those obtained from the sale of widely-held company shares) will have a detrimental influence on the attractiveness of Canadian ventures, where the prospect of capital gains is the main investment incentive, because of the lower rate imposed on similar gains in the U.S.A. Under the White Paper's proposal the capital gains tax would be up to 50% after five years and could be greatly in excess of this high figure in the interim period -- e.g. up to 80% in the first year.

At the present time, gains made in Canada are free from any taxation and this move to alter a positive incentive to a negative deterrent in one fell swoop is felt to be much too drastic and dangerous a proposal. It is therefore recommended that no capital gains tax exceed that in effect in the United States.

It is realized that this would not eliminate the thorny problems of differentiating between capital gains and business income. However, the fact that the gap would be considerably narrowed and that there is now a large body of jurisprudence on the subject, should ameliorate this disadvantage.

The Association also feels that the proposal which would impose a higher rate of capital gains tax on sales of closely-held shares than on widely-held shares would give rise to too many inequities and that action should be taken to remove this imbalance.

If the recommendation with regard to tax rate equality with the U.S.A. is acted on, the problem of widely-held vs. closely-held should automatically be resolved.

(v) Taxation of Middle Income Group

As was described in some detail on pages 9 and 10, construction industry personnel have above-average mobility in employment. Many skilled tradesmen, equipment operators and supervisory and administrative personnel, as well as managerial and professional employees, are in the middle income group. The facts that there is a shortage of trained construction personnel in the U.S.A. and that wages and salaries are in general appreciably higher and taxes lower in that country have already led to the emigration of a good many members of the Canadian construction labour and management force.

Accordingly, the White Paper's proposal to increase taxes on the middle income group is viewed with particular concern in that it would increase further the existing differential in income after taxes and encourage more construction personnel to eimigrate. Alternatively, wages and salaries would have to be increased in order to offset the consequence of the higher income taxes.

Once again, it is stressed that these issues not only relate to managerial and professional personnel but also to a large number of foremen, superintendents, skilled tradesmen and equipment operators in Canada's largest industry, where mobility of employment is perhaps the greatest characteristic of the labour force.

The proposal to increase taxes on the middle income group should accordingly be reconsidered in this light.

(vi) Capital Cost Allowances on Construction Items

a) Rental Buildings - Special Classification

While understanding the reasoning behind the proposals relating to the establishment of separate depreciation classes for each rental building of $50,000 or more in value, the

Association submits that the additional proposal to disallow losses resulting from capital cost allowances, interest or property taxes to be deleted from a taxpayer's "other income" is unduly restrictive. For example, if a professional person switches from renting to owning, he would no longer be able to deduct office rental as an expense and should therefore be allowed his expenses of ownership as an equitable replacement, at least to the extent of the lost rental cost.

More importantly, the Association is concerned with the status of a construction developer who may have a number of projects under way simultaneously. It is our submission that the business losses arising from one project should be properly deductible from income arising from a similar project or related activity. To do otherwise would be grossly unfair, if the losses arise from a "loss venture", e.g. property that has lost value due to zoning changes or other action by Government or third parties beyond the control of the taxpayer. To deny such losses being deducted from so-called "other income" would be tantamount to requiring a manufacturer not to deduct losses from a particularly unprofitable product.

The problem of defining "other income" concerns the Association and, rather than trying to specify that construction is excluded, it is suggested that the establishment of a separate capital cost allowance for each building is sufficient action in this regard and that all current costs should be deducted from the income of a particular taxpayer derived from real estate development or related activities.

b) Capital Cost Allowances - Rates

Concern has been expressed by members of the Association with respect to the Government's announced intention of reviewing capital cost allowances and to inferences in the White Paper that they are now overly generous. Specific details of the Government's plans regarding

capital cost allowances should be made available during the present review of its tax reform proposals in view of the important relationship between these allowances and tax rates, cash flow and capital investment considerations.

(i) Structures and Related Professional Fees

Inasmuch as repairs and maintenance expenses may be written off 100% as operating costs, inadequate capital cost allowances for buildings tend to encourage the penalization of quality in construction specifications in favour of low capital cost and subsequent higher maintenance expenditures. It is submitted that this uneconomical effect is mutually undesirable to the Owners and to the Federal Treasury.

In recent years mechanical and electrical equipment related to the heating, ventilating and air conditioning of buildings and elevators and escalators have comprised an increasingly important factor in the cost of such structures. Similar installations when directly related to production processes would qualify for the 20% capital cost allowance afforded to machinery. Their nature, functions and life expectancy are comparable. Therefore, it is recommended that the mechanical and electrical equipment portions of buildings should qualify for a capital cost allowance of 20%.

On the other hand, expenditures for professional fees, including those of the architectural, engineering and legal professions, made in the design and development of a construction project should be allowed as a business expense rather than be capitalized. The present situation gives rise to inequities. For example, the salaries of designers directly employed by Owners qualify as business expenses whereas competing Owners who engage architects and engineers on a consulting basis must capitalize the fees charged. Accordingly, it is recommended that professional fees involved in the execution of a construction project

should be allowed as current operating expenses of the Owner for the purpose of determining income rather than be considered as a capital cost.

(ii) Construction Equipment and Tools

The same principle applies to construction equipment as to structures with respect to the tendency for inadequate capital cost allowances to encourage repair outlays rather than investment in new and more efficient contractor's plant. Only recently has the annual total of outlays for new construction equipment exceeded the total for construction equipment repair expenditures.

The Association greatly appreciates the action taken by the Federal Government to extend the capital cost allowance rate to 50% for a sizeable group of construction equipment units engaged in the excavation, moving, placing or compacting of earth, rock, concrete or asphalt. However, certain items of a comparable nature still only qualify for the 30% rate. These have been mentioned in several submissions to the Minister of Finance and are summarized in Appendix "C".

In addition, there is a special problem with respect to construction equipment used in remote areas and/or under extremely arduous conditions. In such cases it may well be more economical to abandon or junk the equipment than to pay the cost of return transportation and rehabilitation.

The minor changes in Class 22 required to accommodate the equipment described in the above two paragraphs would have little effect on Federal Government revenues but would be most helpful in assisting the industry's efforts to increase productivity. Therefore, it is recommended that Class 22 of the capital cost allowances be broadened to include flexible tracked vehicles, pick-up and service vehicles, floats and float tractors, trucks etc. used in

quarries or pits, pile driving equipment, cranes, aggregate placing equipment, portable asphalt mixing plants and cement mixers and all construction equipment which is abandoned at the end of a project.

Generating sets used by contractors as a main source of power on remote sites are apparently being classified under Class 2 with a capital cost allowance rate of only 6%. Inasmuch as these sets are essentially construction equipment, it is recommended that electrical generating sets, powered by internal combustion engines with a speed of 900 r.p.m. or more, be included in Class 22 or at least in Class 10.

Class 12(h) continues to have a $100 limit with respect to tools and equipment that may be written off 100% in the year of purchase. This limit fails to recognize the increases in the cost of tools used by on-site workers and the replacement of hand-operated tools by power tools. Moreover, small items of construction equipment -- e.g. pumps -- often are worn out in less than a year. Accordingly, it is recommended that the present $100 limit under Class 10(h) be extended to cover all small tools and short-life equipment of a value up to $1,000.

(vii) Reporting of Construction Income for Tax Purposes

Over the years, problems peculiar to the construction industry have developed with respect to the determination of income for tax purposes. The Chairman of the Royal Commission on Taxation in his opening remarks to the Association during the presentation of its brief, stated that in all his years of professional life he had not encountered a problem more difficult than that of determining the actual performance of a construction company at a particular point in time. Recent decisions by the Department of National Revenue with respect to the calculation of "income" on contracts in process have additionally emphasized the dire need for revisions in the Income Tax Act and its administration, as long advocated by the CCA.

As an administrative procedure, DNR has allowed contractors to elect to use the completed contract method of reporting income on stipulated lump sum contracts of under two years' duration. However, this option is not available with respect to stipulated unit price contracts. Both types of contract are similar with regard to firm prices, risks, etc., although the stipulated unit price contracts have a further complication in that the precise number of units to be executed is not known at the outset. Moreover, inasmuch as the completed contract method is not recognized in the Income Tax Act, taxpayers do not have recourse to the usual appeal procedures.

In view of the above, it is recommended that the completed contract method of reporting income, long approved by the Government, be given legal status in the Act; that it cover both stipulated lump sum and stipulated unit price contracts; and that special provisions be added to accommodate holdback arrangements and other factors impeding the flow of funds to construction companies.

The peculiarities of construction operations are such that the Industry warrants having special provisions in the Income Tax Act, rather than having its members being required to conform to general provisions and procedures that do not fit.

The Association has spent considerable time in developing the precise wording of a proposed Section of the Income Tax Act dealing specifically with the reporting of construction incomes and has engaged counsel to draft such an amendment. The CCA would be pleased to work with officials of the Departments of Finance and Justice with a view to implementing these recommendations by providing them with a copy of its proposed draft and any additional assistance that might be required.

(viii) Carry-Back and Carry-Forward of Losses

Experience in the construction industry has shown that one particularly unfortunate project can give rise to losses of a magnitude that cannot be absorbed by the enterprise in the seven-year period (one year backwards and five years forward) provided in Section 27 (I) in the present Income Tax Act. In this respect, the Association endorses the proposal by the Royal Commission on Taxation, that losses be allowed to be carried forward indefinitely. However, we urge that losses be allowed a carry-back of five years rather than the two-year limit proposed by the Carter Commission. Due to changing areas of activity of individual construction companies within groups etc., the restrictive carry-back period can and does cause hardship, particularly when the losses show up during a review at a date in time which precludes remedial action.

(ix) Consolidated Tax Returns

The proposal in the White Paper that appears to allow a family of closely-held firms to be a partnership, and thus submit a consolidated tax return, is desirable and should be implemented.

Moreover, the Association recommends that the Income Tax Act should contain a provision allowing for consolidated tax returns for related corporations generally.

(x) Association Convention Expenses and Investment Income

The White Paper's proposal that costs incurred by those attending conventions should be disallowed as a business expense for income tax purposes has general application and therefore does not perhaps fall within the intent of this Brief to concentrate on those items which have special significance to the construction industry. And yet, the reaction from the Association's membership to this proposal has been so adverse and universal that the matter must obviously and properly be brought to the Committee's attention.

The proposal is of great concern to the CCA with respect to its future effectiveness. The Association's annual conventions are by far its most important event in the year. Convention attendance would undoubtedly drop very substantially if the Government, in effect, doubled the cost to companies of having their representatives attend. Such a policy would be in direct conflict with Government policies and outlays designed to increase industrial efficiency and productivity.

In the case of the CCA, the annual conventions are deliberately held in late January or early February -- i.e. at a time when construction industry executives can best get away from their businesses. The recent convention held in Edmonton, February 5 - 11, 1970, comprised a comprehensive week of concentrated business and educational programs, attended by delegates from all ten Provinces and from both Territories. It might be added that a good number of senior Federal officials participated in this program and that full use was made of the convention as a medium whereby Government programs and policies were described to and discussed with a nation-wide construction audience.

Conventions, then, enable CCA members to learn about new development and trends and relate them to the operations of their own businesses -- to formulate policies that will help the industry to operate more efficiently and economically -- to make business contacts with many in the industry -- to "talk shop" with construction men from throughout the country (men who may have encountered a similar problem but aren't competitors and are willing to share the benefit of their experience). These are among the reasons why conventions make good business sense to both the delegates and to the economy as a whole.

Important by-products of conventions include the bolstering of Canada's convention and travel trades and helping to develop a Canadian identity. For example, if convention

attendance was not allowed as a business expense under the Income Tax Act, the CCA would tend to hold all of its Conventions in Toronto or Montreal, where most of the potential delegates are located, rather than to follow its policy of taking its conventions to centres throughout the country so that members in other regions may more easily participate every so often.

In summary, the Association believes that there are already sufficient safeguards in the Income Tax Act and its regulations to prevent abuse in the form of improper charging to business expense of those incurred under the headings of conventions, travel or entertainment generally. The implementation of the White Paper's proposal in this regard would seriously reduce the effectiveness of industry associations and other organizations holding conventions and the ability of their respective members to develop business and to improve their efficiency.

It is similarly recommended that the proposal in the White Paper that trade associations' investment income be taxed be withdrawn. In this regard, it is pointed out that non-profit organizations budget in general to balance their revenues and expenditures, but not necessarily in every year.

Revenues are subject to fluctuations and conditions may quickly develop which indicate the desirability of making sizeable outlays not anticipated at the time annual fee schedules are set. These factors have led to the general recommendation that it is prudent for associations to endeavour to accumulate a reserve equal to at least a year's average outlay.

Once again using the CCA's experience as an example, the Association earned some investment income during 1969 but this was exceeded by more than four times by the year's operating deficit which in turn was financed from surplus funds. Had it not been for the latter, the Association might well have hesitated to sponsor the Canadian Inquiry on Construction Labour Relations.

Organizations which have been granted a non-taxable status have to meet certain prerequisites in order to qualify. Many of them obtain income from a variety of sources to enable them to perform the functions that entitle them to be a non-profit organization. Action which would subject one source of income to tax would serve to reduce the ability of the organization to execute its appointed role. This proposal should therefore not be implemented.

(xi) Valuation of Goodwill

The proposal to subject 40% of the proceeds received for goodwill in the first year of the new tax system gives rise to the very genuine concern that, in particular instances, this will amount to very onerous retroactive taxation. For example, the Association cannot agree that goodwill which may have been building up in a company for a generation or two will necessarily be enhanced by 40% just because the purchaser would be able to write the cost of this asset down at 10% per year, as proposed in the White Paper with respect to goodwill and other "Nothings".

The figure proposed by the Government appears to be relatively arbitrary and, in our opinion, unduly high. It is therefore suggested that, in order to avoid retroactive taxation, the percentage deemed to be subject to taxation on the receipts for goodwill be brought down to a figure more in keeping with the write-off proposed to be allowed to the purchaser.

(xii) Advance Tax Rulings on Proposed Business Transactions

Tax implications are fequently a major factor with respect to contemplated business deals such as acquisitions, mergers, etc. It should be possible to obtain prior rulings on the Government's point of view on the resultant tax effects of proposed transactions of this

nature. (A reasonable fee would be in order, so as to discourage frivolous applications for rulings). Action in this regard is all the more important in view of the pending revisions to the Income Tax Act and Canada Corporations Act.

It is therefore recommended that administrative procedures be streamlined so as to provide for prior rulings on the resultant tax effects of proposed business transactions.

In addition, as suggested by the Minister of Finance, it is incumbent upon businessmen to engage in estate planning so as to ensure the most favourable distribution of the estate and continuation of the enterprise. Here again, it is essential that advance rulings on possible tax factors are known when the estate plan is drawn up.

(xiii) Desirable Revisions to Federal Excise Tax Act

The White Paper states that sales tax reform will have to wait until the income tax reforms have been dealt with. The Association wishes to stress that its main recommendations concerning the Federal sales tax do not constitute "reform". In essence, they seek to attain for construction items conformity in treatment under the Excise Tax Act with those of other industries. Action in this regard would have a positive anti-inflationary effect.

a) Construction Production Equipment and Materials

Sales tax on the construction industry's production equipment and on construction materials constitutes a tax on capital investment. Its undesirability has been recognized by previous Federal Governments.

All other industries are exempted from paying the Federal sales tax with respect to their production equipment. All construction equipment, however, bears the full 12% tax at the manufacturer's level. Bearing in mind that new, more efficient production equipment is the construction industry's main medium for increased productivity, it is recommended that

all construction equipment be exempted from the 12% Federal sales tax, in conformity to the exemption afforded to all other industries for their production equipment.

The Royal Commission on Taxation stated that there is "neither economic nor social justification for the taxation of building materials". If revenue considerations do not allow the complete repeal of this impost on construction items, consideration should be given to granting relief by rebate on additional types of construction projects, such as is now afforded to schools, hospitals and certain other institutional buildings. It will be recalled that the Carter Commission gave top priority in this respect to materials used in the construction of producer goods projects.

Nor is it correct to assume that the Federal Government is merely "taking money from one pocket and putting it in another" with respect to its public works projects, housing projects financed largely or wholly with Federal funds, and other projects receiving Federal grants. The 11% or 12% Federal sales tax which the Federal Government collects on construction materials at the manufacturer's level may well pyramid to 15% or more by the time the materials are installed on the job-site. The taxpayers pay the difference.

The proposed Federal sales tax rebate system is very flexible in that relief can be given to certain types of project and/or certain regions of the country. In summary, it is recommended that the Federal Government exempt all construction materials as soon as possible and, if this must be achieved in stages, afford relief by rebate on additional selected categories of project.

b) Prefabricated Construction Items and Components

Section 29(2b) of the Excise Tax Act is incomplete in its coverage and therefore acts as a deterrent to the industry's endeavours to improve productivity and reduce costs by means of increased prefabrication. The Section also causes inequities and administrative confusion by

providing that certain manufacturers are not deemed to be manufacturers for the purposes of the Act. Pending the complete exemption of all construction items, it is recommended that Section 29(2b) be amended to include all prefabricated construction items and components; and to provide that the goods involved are taxable at the manufacturer's material purchase cost.

c) Anti-Pollution Equipment

Anomalies exist with regard to the Federal sales tax treatment of pollution control equipment. For example, Municipalities have been granted an exemption for sewerage and drainage systems, but not for water filtration plants.

Moreover, Industry is eligible for a sales tax exemption for installations carrying waste, but not for anti-pollution equipment. In other words, if a factory installs a pipe which carries industrial waste into a river, the pipe and pumps are tax-free but if the company installs anti-pollution equipment to cleanse the waste before it goes into the river, the installation is taxable!

Then again, equipment which is placed on factory chimneys to take waste particles out of the air is only exempt from Federal sales tax if the removed particles are subsequently sold -- i.e. if the equipment is part of a production process. If there is no market for the salvaged materials and the equipment is installed solely as an anti-pollution measure, then it bears the full tax. An example within the construction industry in this regard is the smoke from asphalt plants used for paving operations.

Bearing in mind the cost of pollution control equipment and the high priority for its installation, it is recommended that the Federal sales tax exemptions now afforded to some types of anti-pollution equipment be extended to all such pollution control facilities.

d) Responsibility for Exemption Certificates

The Excise Tax Act holds the vendor responsible for any sales tax liability arising from the improper use of exemption certificates by purchasers. It is unreasonable to expect vendors to detect false declarations in this regard or to take court action if it has to be proven that customers falsely represented that the goods were to be used for tax-exempt purposes. Accordingly, it is recommended that the Act be amended to permit such certificates to be made out by the purchaser to the Crown, with a copy for the vendor, thereby making the purchaser responsible for his statements, rather than an innocent third party.

APPENDIX "A"

MEMBER ASSOCIATIONS OF THE CANADIAN CONSTRUCTION ASSOCIATION AND LOCATIONS OF THEIR HEADQUARTERS

Newfoundland

St. John's	Newfoundland & Labrador Construction Association
	Newfoundland & Labrador Road Builders Association

Nova Scotia

Halifax	Construction Association of Nova Scotia
	Nova Scotia Road Builders' Association
Sydney	Construction Association of Nova Scotia - Cape Breton Branch

Prince Edward Island

Charlottetown	Prince Edward Island Construction Association
Summerside	Prince Edward Island Road Builders' Association

New Brunswick

Bathurst	Northeastern (N.B.) Construction Association
Edmundston	Edmundston Construction Association
Fredericton	Fredericton Construction Association
	New Brunswick Council of Construction Associations
	Road Builders' Association of New Brunswick
Moncton	Moncton Construction Association
Saint John	Saint John Construction Association

Québec

Chicoutimi	Association des Constructeurs Saguenay-Lac St. Jean
Drummondville	L'Association Patronale des Constructeurs du Diocèse de Nicolet
Granby	L'Association des Entrepreneurs en Construction de Brôme-Missisquoi-Shefford
Hull	Association des Constructeurs du District de Hull et de L'Ouest du Québec
Montreal	Canadian Institute of Plumbing & Heating
	Canadian Roofing Contractors' Association
	Corporation of Master Electricians of Quebec
	Montreal Construction Association
	Quebec Concrete Association

Québec (cont'd)

Noranda	Western Quebec Construction Association
Québec	Association de la Construction de Québec
	La Fédération de la Construction du Québec
	Quebec Road Builders' and Heavy Construction Association
St-Hyacinthe	L'Association des Constructeurs St-Hyacinthe
Sherbrooke	L'Association des Constructeurs des Cantons de l'Est
Trois Rivières	L'Association des Constructeurs de la Mauricie

Ontario

Barrie	Barrie Builders' Exchange Service
Belleville	Quinte Construction Association
Chatham	Chatham Builders' Exchange
Guelph	Guelph Construction Association
Hamilton	Hamilton Construction Association
Kingston	Kingston Builders' Exchange
Kitchener	Kitchener-Waterloo Construction Association
Leamington	Builders' Exchange of Leamington
Lindsay	Lindsay and District Construction Association
London	London & District Construction Association
Orillia	Orillia District Builders' Exchange
Oshawa	Oshawa & District Construction Exchange
Ottawa	Canadian Association of Equipment Distributors
	Canadian Builders' Supply Association
	Ottawa Construction Association
	Portland Cement Association
Peterborough	Peterborough District Construction Exchange
St. Catharines	Niagara Construction Association
St. Thomas	St. Thomas & Elgin Builders' Exchange
Sarnia	Sarnia Construction Association
Sault Ste. Marie	Sault Ste. Marie Builders' Exchange
Sudbury	Sudbury Construction Association
Thunder Bay	Construction Association of Thunder Bay
Toronto	Aggregate Producers Association of Ontario
	Canadian Association of Painting and Decorating Contractors
	Canadian Automatic Sprinkler Association
	Canadian Institute of Steel Construction
	Canadian Plumbing & Mechanical Contractors Association
	Canadian Prestressed Concrete Institute
	Canadian Sheet Steel Building Institute
	Canadian Structural Clay Association
	Construction Industry Credit Bureau, CCMA

Ontario (cont'd)	
Toronto (cont'd)	Electrical Contractors Association of Ontario
	Mechanical Contractors Association of Toronto
	Metropolitan Toronto Sewer & Watermain Contractors Association
	National Concrete Producers Association
	Ontario Federation of Construction Associations
	Ontario General Contractors' Association
	Ontario Refrigeration & Air Conditioning Contractors Association
	Ontario Road Builders' Association
	Ready-Mixed Concrete Association of Ontario
	Terrazzo, Tile & Marble Association of Canada
	The Insurance Bureau of Canada
	Thermal Insulation Association of Canada
	Toronto Construction Association
	Toronto & District Excavators Association
Windsor	Windsor Construction Association
Manitoba	
Brandon	Brandon Builders' Exchange
Winnipeg	Manitoba Concrete Products Association
	Roadbuilders & Heavy Construction Association of Manitoba
	Winnipeg Builders' Exchange
Saskatchewan	
Moose Jaw	Moose Jaw Construction Association
Prince Albert	Prince Albert Construction Association
Regina	Prairie Road Builders' Association
	Regina Construction Association
	Road Builders & Heavy Construction Association of Saskatchewan
	Saskatchewan Construction Association
Saskatoon	Saskatoon Construction Association
Swift Current	Swift Current Construction Association
Alberta	
Calgary	Calgary Construction Association
Edmonton	Alberta Construction Association
	Alberta Road Builders' Association
	Edmonton Construction Association
Grande Prairie	Grande Prairie Construction Association
Lethbridge	Lethbridge Construction Association

Alberta (cont'd)

Lloydminster	Lloydminster Construction Association
Medicine Hat	Medicine Hat Construction Association
Peace River	Peace River Construction Association
Red Deer	Red Deer Construction Association

British Columbia

Dawson Creek	Dawson Creek - Fort St. John Construction Associations
Kamloops	Southern Interior Construction Association
Prince George	Prince George Construction Association
Vancouver	Amalgamated Construction Association of British Columbia
	British Columbia Construction Association
	British Columbia Road Builders Association
	Electrical Contractors Association of British Columbia
	Master Sheet Metal & Roofing Contractors Association of B.C.
	Pipeline Contractors Association of Canada
Victoria	Amalgamated Construction Association of British Columbia - Victoria Branch

Yukon Territory

Whitehorse	Yukon Builders' Exchange & Construction Association

APPENDIX "B"

CANADIAN CONSTRUCTION ASSOCIATION

CONSTRUCTION HOUSE, 151 O'CONNOR ST.,
OTTAWA 4, CANADA
AREA CODE 613/236-9455

April 30, 1969.

Hon. Salter A. Hayden, Chairman,
and Members of the Banking, Trade
& Commerce Committee,
The Senate,
Parliament Buildings,
Ottawa 4, Canada.

Honourable Senators:

Re: Bill C-165, Estate & Gift Taxes

The Canadian Construction Association very much appreciates the opportunity of presenting its views on the above-mentioned Bill in the appended Brief. The matter is of widespread and very special concern to our Members.

The Construction Industry is Canada's largest. Virtually all construction companies, equipment distributors and builders' supply firms are family or closely-held concerns. Moreover, firms in our industry are typically short on liquid assets. This combination of factors has meant that members of the construction industry have found estate taxes and succession duties especially onerous.

The Association has stressed many times in the past the deleterious effect that death duties have on the growth and continuation of family firms and on initiative and enterprise generally. When the Budget was introduced last October, the CCA immediately expressed its appreciation of the exemption of spouses from estate taxes but also its grave concern at the increased taxes that would have to be paid in the case of many estates due to the application of higher rates on much smaller estates and the integration of estate and gift taxes. A series of representations have subsequently been made on behalf of the industry.

The main points contained in these submissions have already been dealt with in detail during the Senate Debate following the Bill's first reading. It was therefore concluded that a lengthy treatment of them in the appended brief was unnecessary. The Association would like, however, to stress at this hearing the application of these general principles to the construction industry, rather than to the specific wording and administrative aspects of the Bill.

All of which is respectfully submitted,

INDEX

1. SUMMARY OF RECOMMENDATIONS

1. That the previous schedule of estate taxes be maintained pending further study.

   Such action would:

   a) permit the consideration of estate taxes in the light of other proposed tax reforms to be included in the Federal Government's White Paper in a month or so's time.

   b) enable the elements of relief contained in Bill C-165 which enjoy widespread support, such as the exemption for spouses and the option of tax payment in instalments, to be enacted. (The option of using either the previous or new exemptions until next August has already been granted).

   c) permit discussions with the Provincial Governments who currently receive up to 75% of estate tax gross revenues and in several cases are committed to a policy of rebating their shares or have it under serious consideration.

   d) afford some measure of assurance to members of family firms who are adversely affected by the new schedules of estate and gift taxes.

2. That the passage of closely-held companies from one generation to another be allowed without attracting estate taxes so onerous that they constitute a major factor in selling or closing down such firms.

   In this regard, it is again suggested that serious consideration be given to an Ontario Economic Council proposal that the value of shares of private Canadian corporations be exempted from estate tax when passed to members of the immediate family. (Subject to their not being sold for a minimum period of ten years and other safeguards).

2. SIZE AND NATURE OF THE CONSTRUCTION INDUSTRY

The Construction Industry is Canada's largest and operates in all sections of the country. The value of the construction program this year is estimated to be some $13.3 billion. (Federal Government's White Paper, "Public and Private Investment, Outlook 1969"). Construction outlays in Canada have on average accounted for roughly one-fifth of the Gross National Product. They now provide jobs in construction operations to the year-round equivalent of some 600,000 Canadians and to an even larger number engaged in the manufacturing, transporting and merchandising of construction materials, components and equipment.

D.B.S. estimates that over 80% of the construction program is carried out by contractors. The balance is executed by Owners ranging from those with sizeable construction crews to the 'do-it-yourself' individual. Even where prime contractors are not used, the construction materials, components and equipment are supplied by private firms. Moreover, equipment may be rented from private firms and some of the construction work let to specialty contractors. The trend is towards increasing use of the Contract Method.

The family firm or one which is "closely-held" appears to have characteristics that are especially appropriate for the construction industry. All but a handful of the general contractor, trade or specialty contractor, equipment distributor and builders' supplier firms are in this category. Many are sizeable concerns with annual volumes of business amounting to millions of dollars. Even some of those which are publicly listed are still controlled and operated by the founding family. A good many of the firms manufacturing construction products are also family or closely-held firms.

The very high proportion of such companies in the construction industry is obviously due in large measure to the facts that entry into the industry is easy and that many firms are small or medium-sized. And yet, as mentioned above, there are also a sizeable number of multi-million dollar firms that are family enterprises. Capital investment in equipment etc. is often heavy. Construction is a high risk business with many hazards. Competition for work is extremely keen. These factors are such that a high degree of personal financial stake and involvement in the management of construction companies seem to be particularly important elements in their success. Similarly, many large manufacturing concerns as a matter of policy select family firms to act as their distributors in order to have the same qualities of aggressive, personal operation.

The construction program is made up of approximately 60% building construction, of which half is residential construction, and 40% engineering construction. The high degree of specialization is reflected by the abundant use of sub-contractors and sub-sub-contractors. This and the fact that those directing the operations of each specialist contractor have a personal incentive to see that the work is carried out as quickly and economically as possible, have been cited as the main reasons why construction work is carried out faster and with a smaller on-site labour force in North America than in Europe.

3. CCA POLICY STATEMENT ON ESTATE TAXES

For many years the Association has contended that the benefits to the state of the relatively small revenues derived from death duties have been more than offset by their inherent deterrents to initiative and economic expansion. Accordingly it was recommended that they be abolished and that,

for immediation relief, the exemptions for estate taxes be raised to $100,000 and that an option be provided for the deferment for one year of the evaluation of an estate.

At the last CCA Annual Meeting (Montreal, January, 1969) the views of the Association were incorporated in the following Statement of Policy adopted by delegates at the closing session:

"Estate taxes and succession duties work to the detriment of family-owned businesses by preventing them from being passed on in viable form. At the same time, they encourage the removal of large capital holdings together with managerial ability from the country with consequent hardship to employees. It is therefore recommended that estate tax be amended to provide for the passage of family-owned enterprises to members of the immediate family."

4. DIFFICULTIES EXPERIENCED BY CONSTRUCTION INDUSTRY FIRMS DUE TO DEATH TAXES

It has been recognized by the Minister of Finance that estate taxes place a special burden on family firms and on estates in which the major assets are not liquid. Both factors are the norm in the construction industry. The two main assets of a contracting firm are usually know-how and equipment. Neither are liquid in nature. Moreover, the firm may well also have considerable indebtedness.

The combination of these conditions has caused considerable problems in the continuation of the typical construction firm. Indeed, the very prospects of having to pay estate taxes and succession duties have been an important factor in the sale of firms in the construction industry. It should be noted that there is normally a very limited market for shares of construction firms and that potential purchasers are often only interested if they can acquire a controlling interest.

In addition, difficulties have frequently been experienced in arriving at the proper value of a share in a construction company. Very few are listed. Often the death of a principal shareholder will in itself have a very marked effect on a share's value. That such evaluations can only be arbitrary decisions is reflected by the fact that there are often appreciable differentials between those established by Federal estate tax officials and Provincial succession duty officials.

The above has occasioned serious problems in the past. The provisions of Bill C-165 will further increase the estate tax problems in the case of many members of the construction industry inasmuch as the rates of tax have been increased so that, for example, the 50% rate will apply on estates of $300,000 and gift taxes are to be integrated with estate taxes.

A $300,000 estate is not a large one, relatively speaking, in modern times. Moreover, the integration of gift taxes with estate taxes and the continuation of inflation will likely mean a trend towards an increased number of estates of this size and over. The 50% rate did not previously apply to estates in Canada until they were $1,550,000 and it is understood that it applies in the United States only when the $2,500,000 level is reached. Thus the incidence of the tax is much greater on sizeable estates then in the past and it is very considerably out of line with that levied in the U.S.A.

Accordingly, deep concern has been expressed over the increased problem that the sons in established family firms will face when both their parents die, in term of being able to carry on a business which has little in the way of liquid assets. The exemption afforded to spouses gives relief but it may be of short duration and be more than offset by

the higher rates of estate taxes. In some cases the head of a family firm is already a widower.

Similarly, the option of paying estate taxes over a period of years will also be helpful in a number of cases. However, the fundamental question is really whether sizeable sums of money can be paid -- even over a five-year period -- and still be able to operate the company. Incidentally, the Federal Government's position as a preferred creditor in these circumstances will reduce the ability of construction companies to obtain surety bonds which are required by the Federal Government and many other Owners as a condition of being awarded a contract.

In the past the schedule of rates for estate taxes have been changed infrequently. It is greatly feared, therefore, that if the increased rates of tax contained in Bill C-165 are enacted by Parliament they will likely not be subject to review or revision for a lengthy period. Moreover, there is no knowledge at this time of the Federal Government's intentions with respect to the recommendations of the (Carter) Royal Commission on Taxation. If, by chance, a capital gains tax is imposed and a deemed capital gain held to occur at time of death, the whole impact and problem of death taxes with respect to the continued operation of family firms with little liquidity would be escalated still further.

The Association is aware that the Carter Commission stated that there was nothing special about family-owned firms that necessarily made them more efficient than others and that a study commissioned by it on Death Taxes stated that there was not much factual evidence to support the contention that such taxes caused family firms to sell out either to large corporations or to foreign interests or to both. With regard to the first opinion, the Association contends strongly that family firms do

seem to be well-suited to carry out most construction operations. With regard to the second point, it is not known if the construction industry was included in the authors' study. We do know, however, that our industry has faced serious problems with respect to death taxes in the past leading to sell-outs. The future prospects are for more of this due to higher taxes under the provisions of Bill C-165.

Up until now, the references to difficulties caused by estate taxes have been related to those experienced by members of the family paying them. The position of company employees is often of sincere equal concern to those operating family firms. In many cases these employees have worked most of their adult lives in helping the business to operate and expand. The incidence of onerous death taxes on those operating a family firm will either restrict its operations or lead to its sale or closing down. Alternatively, the prospects of paying death taxes also lead to sell-outs. In the former case where the company business is curtailed the long-term employee may well suffer by way of reduced bonuses, pay increases or scope for advancement. If the firm is sold or closes down, employment in a similar position is by no means guaranteed and there frequently would be losses in terms of fringe benefits.

Another problem caused by the prospects of high rates of death taxes is one experienced by the country as a whole. Reference here is made to the departure of successful executives to "tax havens" or to other regions where the incidence of income and death taxes is lower than in Canada. The capital they take with them constitutes an appreciable loss but perhaps of even greater concern is the loss of executive ability in the persons departing. Their talents and drive are also sorely needed and they may well be a decade or more before normal retirement age.

5. DETERRENTS TO ESTABLISHMENT, OPERATION AND EXPANSION OF BUSINESSES

The Association has no desire to indulge in extreme talk on the deterrent effect which taxes in general or death taxes in particular have on incentives. At the same time, it is believed that greater recognition should be given by the Federal Government to the effects that they have on decisions related to the establishment, operation and expansion of businesses. And it is largely upon the initiatives shown by these enterprises that Canada's economic development and the revenues of governments are based.

It is doubtless true that people are more aware of income taxes than of death taxes. For one thing, payment of income taxes is an ever-present experience. Yet it is possibly due to this awareness of income taxes that causes members of our industry to be especially concerned about death taxes. After having paid corporation income tax and other business taxes and having ploughed back hard-won earnings into the business, the knowledge that they are not free to dispose of their personal savings (notwithstanding the fact that they have borne high rates of personal income tax) causes special resentment.

Accordingly, it is not so much a question of the number of estates which attract the higher rates of tax as it is the effect of the prospects of such taxes in the future on present investment and other business decisions. Will a capital outlay be cancelled on the grounds that it may well cause estate tax problems by reducing company liquidity? Will a new business venture or expansion be decided against on the basis that net returns after income and death taxes make the risk involved unattractive?

The number of people who attempt to create and perpetuate businesses in Canada is relatively few. Risk capital and enterprise are urgently needed. Is it worth risking a reduced incentive for the expansion or continued operation of their firms for the relatively small net amount of tax revenues that the higher rates of tax on estates and gifts will bring? Psychological speculation on entrepreneurial motivation is a luxury that this country cannot afford.

As mentioned, construction is a high risk industry. Years of effort and long hours of labour may go unrewarded or the build-up of company resources wiped out by conditions on one or two contracts. Fluctuations in the construction cycle are marked. Weather and terrain can cause serious problems. Competition is high and the casualty rate is heavy. When times are tough, the employers may pay themselves less than their employees to keep the company from going under. For those who succeed, however, the rewards may be high. This is a powerful incentive.

It is not only vital that there be sufficient incentives to encourage people to establish businesses but also to expand them. Conversely, it is most undesirable if those who have built up a successful family or closely-held firm know that its future operations may well be in jeopardy because of death taxes. Economists predict that the demands to be placed on the construction industry for its services are due to be increased very greatly during the balance of the century. Its growth should be encouraged, not deterred. The risks contained in the new estate tax schedule of rates would seem to be out of all proportion to the revenue involved.

6. CONCLUSIONS AND RECOMMENDATIONS *

Several of the Provincial Governments have already recognized the undesirable features of high death taxes. Two rebate their 75% share of

* cf. also page 1.

gross estate tax revenues; others plan to do so. In such regions capital investment, business expansion and the retention of successful executives have been encouraged. In view of this trend, it would seem inconsistent, to say the least, to proceed with legislation which (while affording measures of relief in some respects) imposes higher taxes on many estates.

Moreover, it is difficult to segregate this one area of tax reform from all of the others. In view of the fact that the Federal Government is soon to publish a White Paper on Tax Reform, it would seem only reasonable to defer enacting at least those portions of Bill C-165 which involve higher taxes until the White Paper can be studied.

The Association has in the past drawn attention to a recommendation in a report published by the Ontario Economic Council which is designed to allow the passage of closely-held corporations from one generation to another or to other members of the immediate family without the attraction of estate taxes, or at least that a significant reduction in the rate of tax be allowed in such cases:

> "That where more than ten percent of the issued and paid-up capital of a private Canadian corporation possessing assets of which not more than ten percent are securities of public corporations or government is represented by shares owned by a deceased at the time of his death, the value of such shares be included in determining the rate of transfer tax to be applied to other estate assets, but such value be exempted from transfer tax unless such shares are sold within a period of ten years."

Such a measure would facilitate the growth of Canadian enterprises and it is recommended that it be given serious study and that it be expanded to include non-corporate enterprises.

When the exemption for spouses from estate tax was announced in the Budget Address last October, reference was made to the fact that the wife had often played a major part in the development of an estate. The same is true of many sons or nephews who have devoted many years of their lives to the building up of a family business in the construction industry. This fact deserves full consideration.

APPENDIX "C"

PROPOSED CHANGES TO CLASS 22 IN THE CAPITAL COST ALLOWANCE REGULATIONS WITH RESPECT TO CONSTRUCTION EQUIPMENT ITEMS

Class 22 should be broadened to include appropriate items now not presently covered such as:

a) Flexible, Tracked Vehicles - These are required for all types of exploration and construction work in the more isolated areas of Canada especially in muskeg areas, and particularly in winter. These vehicles are used as carriers on which are mounted a great variety of loads. They are used as personnel carriers, trucks and tractors. They are subject to very high maintenance costs and short life. They should be included in Class 22 since 50% depreciation on the undepreciated balance realistically expresses the actual life of this equipment.

Furthermore, construction and exploration in the remote areas of Canada should be encouraged, not penalized, as the present classification of this type of equipment tends to do.

b) Pick-up and Service Vehicles (four wheel drive) - This type of equipment experiences actual physical depreciation of 50% per year on the declining balance. It is required for construction in the remote areas of Canada and, therefore, should be included in Class 22 to help encourage the development of these areas.

c) Floats and Float Tractors - These are designed and used specifically for transporting Class 22 moveable equipment to job-sites, and should, therefore, be included with those assets for capital cost allowance.

d) Trucks and Other Equipment used in Quarries and Pits - Currently these units fall under the Mining category and are specifically excluded from Class 22. In view of the radical proposals re mining depletion allowances and tax holidays it is urged that this construction equipment now be included in Class 22.

e) Pile Driving Equipment - This equipment should be included under Class 22 because of high maintenance costs and because the placement of concrete piles or a substitute to create structure foundations, or to protect an excavation from caving in is an integral part of excavation and foundation construction.

f) Cranes - Very often these are used in an excavator or concrete placement configuration and as such are the fundamental machines for that operation. They should not be penalized because they can do other work.

g) Aggregate Producing Equipment (crushing/washing/screening) - These units are often used by contractors exclusively for the construction industry. The nature of the work done by this equipment makes it depreciate as rapidly as any other equipment used in the road building industry.

h) Portable Asphalt Mixing Plants and Portable Cement Mixers - Again, the nature of the work done by this equipment makes it depreciate as rapidly as any other equipment used in the road building industry.

APPENDIX "D"

SUMMARY OF RETURNS TO CCA QUESTIONNAIRE

WHITE PAPER ON TAXATION - EFFECT OF PROPOSED CHANGES ON YOUR OPERATIONS

Please complete and return this Questionnaire to Canadian Construction Association, 151 O'Connor Street, Ottawa 4, Ontario

The radical proposals for tax reform contained in the White Paper recently tabled in the House by the Minister of Finance, Hon. E.J. Benson, have received widespread publicity. The Canadian Construction Association and other interested groups and individuals have expressed concern over the combined impact of some of the proposals and existing estate tax legislation on the continuance of family-owned enterprises. The matter was reviewed at the CCA Legislation & Taxation Committee Pre-Convention meeting held on December 1, 1969. It was the decision of the Committee that in order for the Association to represent properly the wishes of the total membership, it was necessary to solicit the views of all members on the various aspects of the proposed tax reform.

It would therefore be appreciated if you would complete the following questionnaire and return it at your earliest convenience. It is understood that many members are awaiting the report of their professional advisors as to the effect of the proposals on their operations. If your reply will be delayed pending such a report or for any other reason, it would be appreciated if you would advise as to the approximate date that the completed questionnaire will be forwarded to Construction House.

If we don't hear from you, it will be assumed that either you favour the proposed tax reforms and/or the changes suggested will have little or no effect on your operations.

I. Name of Company: Total - 366 = 100%

II. Category: (Please check)

Building contractor 113 = 31%	Trade contractor 151 = 41%
Road Builder and Heavy Construction 23 = 6%	Manufacturing contractor 13 = 4%
Manufacturer and supplier 66 = 18%	

III. Average Gross Revenue from construction:

Total = 366 = 100%

Under $100,000.00 40 = 11%	$100,000.00 to $500,000.00 108 = 30%
$500,000.00 to $1,000,000.00 55 = 15%	$1,000,000.00 to $3,000,000.00 71 = 19%
$3,000,000.00 to $5,000,000.00 29 = 8%	$5,000,000.00 to $10,000,000.00 22 = 6%
Over $10,000,000.00 41 = 11%	

IV. We would appreciate hearing from you the assessment of the effect of the following proposed changes in the Canadian tax law on the continuing operation and growth of your business:

A. Profound effect, ability to continue in business in doubt

B. Serious effect, will probably retard proper growth

C. Little or no effect

1) Proposed removal of low rate of tax on company income below $35,000.00, bearing in mind the full effect of the proposal to integrate personal and corporate income for closely-held corporations.

Total 370 = 100%	A	B	C
Comments	56 = 15%	252 = 68%	62 = 17%

(see paragraphs 419 - 445 - White Paper)

2) Effect of the proposed taxation of capital gains at full income tax rate for shares of closely-held corporations.

Total
322 = 100%

(see paragraph 3.31 - White Paper)

A	B	C
Comments:		
59 = 18%	188 = 58%	75 = 24%

3) Effect of capital gains on widely held shares being taxed at 50% of the full income tax rate, bearing in mind the proposal to deem realization of capital gains every five years.

Total
299 = 100%

(see paragraph 3.32 - White Paper)

A	B	C
Comments:		
42 = 14%	119 = 40%	138 = 46%

4) The effect of 2) and 3) on the continuation of your business, bearing in mind the estate tax amendments introduced last year and the proposal by the Government that no deemed realization of capital gains takes place at the time of death but only at the time of sale.

Total
293 = 100%

A	B	C
Comments:		
81 = 28%	115 = 39%	97 = 33%

5) Proposal to change Capital Cost Allowances on rental buildings costing $50,000 or more to establish a single class for each structure to force earlier recapture of depreciation. Also disallowance of losses on buildings arising from capital cost allowances interest or property taxes to offset other income.

Total
289 = 100%

(see paragraph 5.17 - White Paper)

A	B	C
Comments:		
31 = 11%	100 = 35%	158 = 54%

6) Proposal to eliminate club and convention expenses for tax purposes. We don't expect this to be as serious as the other questions with regard to the continuation of your business, but would appreciate your comments on the proposal, particularly with regard to your participation at CCA Conventions and other meetings.

(see paragraph 5.9 - White Paper)

Comments:

Most comments strongly opposed to this proposal. Disallowance of convention expenses would work particular hardship on taxpayers remote from main business centres.

APPENDIX E

CONSTRUCTION COMPANY PROFITS AND LOSSES

1965 - 1967: DBS #61-207
1960 - 1964: DNR Corp. Statistics

(These two series are calculated on somewhat different bases)

	Number of Profit Companies	Number of Loss Companies	Total Number Reporting	Percentage Reporting Loss	In Million of Dollars, Current Year	
					LOSS	PROFIT
1967			16,183		68.8	244.7
1966			14,846		44.8	210.8
1965			15,315		49.4	167.4
1964	9345	4499	13,844	32.5%	67.7	148.7
1963	8215	4495	12,710	35.4%	71.1	132.8
1962	7954	4762	12,716	37.4%	66.9	137.9
1961	7327	4574	11,901	38.4%	50.3	141.5
1960	7215	3956	11,171	35.4%	59.2	137.1

CORPORATION PROFITS - VARIOUS INDUSTRIES
DBS - #61-207

For the year 1967 (latest reported)	Sales of Reporting Companies	Profits of Reporting Companies	Percentage Profits of Sales
Construction	$ 7,615.0 million	$ 175.9 million	2.30
Fishing & Trapping	21.1	.8	3.79
Agriculture	417.0	15.9	3.81
Total Manufacturing	42,392.9	1,622.4	3.82
Paper & Allied Industries	3,664.8	182.6	4.98
Total Service Industries	3,530.8	188.0	5.32
Petroleum & Coal Products	1,844.8	127.4	6.90
Total Mining	4,921.2	737.1	14.97

APPENDIX F

COMMERCIAL FAILURES
Under the provisions of the Bankruptcy and
Winding Up Acts (DBS #61-002)

YEAR	CONSTRUCTION GENERALS	CONSTRUCTION TRADES	CONSTRUCTION TOTAL	TOTAL ALL INDUSTRIES	
1969	168 15962	272 19997	440 35959	2695 210950	* Number of failures ** Liabilities in thousands of dollars
1968	177 16542	265 11066	442 27608	2516 180735	* **
1967	193 38422	258 16427	451 54849	2631 218064	* **
1966	219 22083	340 16819	559 38902	3007 247467	* **
1965	243 28862	385 24411	628 53273	3295 393650	* **
1964	308 35663	398 14313	706 49976	3449 208734	* **
1963	273 23269	441 16915	714 40184	3677 195602	* **
1962	244 17056	329 10693	573 27749	3190 149440	* **
1961	195 13535	275 10130	470 23665	2659 116520	* **
1960	271 19444	336 13717	607 33161	2828 174548	* **
1959	177 11272	272 10596	449 21868	2229 95786	* **

	NUMBER		LIABILITIES	
	1968	1969	1968	1969
Construction	442	449	$ 27,608,000	$ 35,959,000
Manufacturing	267	277	32,081,000	40,046,000
Services	382	417	23,114,000	23,910,000
Transportation & other utilities	168	203	7,251,000	7,790,000
Trade	1,061	1,149	56,557,000	50,668,000
Other	196	209	34,124,000	52,577,000

APPENDIX "C"

MARKBOROUGH
PROPERTIES LIMITED

50 Holly Street, Toronto 7, Canada

Telephone 481-5251

SUBMISSION TO THE SENATE STANDING COMMITTEE
ON BANKING, TRADE AND COMMERCE
CONCERNING THE GOVERNMENT'S PROPOSALS
FOR TAX REFORM

MARKBOROUGH PROPERTIES LIMITED

SUBMISSION ON THE GOVERNMENT'S WHITE PAPER ON TAX REFORM

INDEX

A. THE COMPANY

Markborough Properties Limited is a property development and investment Company formed to undertake the development of large scale residential, commercial and industrial projects across Canada and to acquire income producing properties for investment. The Company's shares are listed on the Toronto Stock Exchange, and are held by over 2,000 shareholders, none of whom owns more than 10% of the total shares outstanding. The Company currently owns over $56,000,000 of developed and undeveloped real estate, located in five urban areas across Canada.

B. SUMMARY OF SUBMISSION

We believe that certain of the government's proposals for tax reform would have damaging effects on the full development potential of the country by dangerously reducing the amount of capital available for the servicing of land and the construction of new housing and commercial buildings. The development of adequate housing and other construction is vital to the economy of the country and the well-being of the Canadian people.

One of the overall effects of the proposals would be to restrict the accumulation of investment capital and to cause a substantial shift in the flow of that capital from bonds and mortgages to mature equities. The government itself states that "some moderate reduction in aggregate private savings" would occur. Whether the reduction will indeed be "moderate" remains to be seen; what the government does not mention is that a more important consequence is likely to be a not so moderate effect on the bond and mortgage markets, and on the supply of housing and other buildings.

The shortage of mortgage capital is already placing severe stresses on the real estate industry. Money is in great demand and short supply; interest rates and housing costs are skyrocketing. (The average cost of a new house in Metropolitan Toronto was about $42,000 in 1969 compared with about $21,000 in 1965.) Inflation is discouraging potential investors of mortgage capital, and this in turn is discouraging potential investors of real estate development risk capital.

It is in this setting that the government now proposes to introduce tax measures which would discriminate directly against the real estate industry. Companies in that industry would effectively be prohibited from deducting full capital cost allowances on the same basis as companies in other industries; in many cases they would be denied deductions for interest and realty taxes, which are necessary and legitimate business expenses.

The government's proposals concerning capital cost allowances and interest and realty taxes, if implemented, can only further discourage equity investment in real estate development and lead to an even more serious decline in new residential construction. No explanation is offered as to why these sharply restrictive and complex rules should apply only to the real estate industry, and why this industry is being singled out for adverse treatment.

We also believe that the proposals concerning convention and entertainment costs and capital gains on principal residences are unrealistic and inequitable and could have adverse effects on certain segments of the economy and on the freedom of movement of taxpayers.

This submission contains our detailed comments on these proposals, together with certain modifications and amendments to the White Paper proposals which we suggest should be adopted. It also includes some comments on the possibility of introducing incentives for the purpose of combatting the shortage of mortgage capital.

C. GENERAL IMPACT OF WHITE PAPER ON SUPPLY OF CAPITAL

The government's proposals will have a very definite effect on the amount of capital available for investment and on the types of investment into which this capital is channelled.

Taxes on capital gains and higher rates of tax on middle and upper income taxpayers affect mainly those taxpayers who are able to accumulate capital, and a reduction in aggregate private saving would result. Part of

this reduction will be effectively passed on to low income taxpayers who are less able to save, and to this extent capital previously available for investment will, because of the White Paper proposals, be used for private consumption. Another effect of these additional taxes will be to shift capital from the private to the public sector, a shift which will be further strongly reinforced by the fact that the proposed tax system will raise very substantially more taxes than the present tax system. It is not known how this extra capital will be utilized by the government, but it is reasonable to assume that it will not all be used for investment purposes.

The White Paper's integration proposals will make equity investment more attractive, and will cause a shift of capital from fixed debt investment, such as bonds and mortgages, to investment in equities. Furthermore, the proposals will divert capital from investment in smaller, growth companies to investment in mature established companies with large amounts of "creditable tax" and consistent dividend records.

In summary then, the implementation of the White Paper will result in a decrease in the supply of capital, and a diversion of the remaining available capital from fixed debt investment and investment in growth equities to investment in mature equities.

D. SUPPLY OF REAL ESTATE DEVELOPMENT CAPITAL

Unlike some other industries, real estate development is a "capital intensive" industry. Servicing land involves building roadways, installing water and sewage systems, providing other functional and environmental necessities in the development of property, as well as constructing housing and commercial buildings requiring the continuous investment of vast amounts of capital.

At the present time, the supply of bank loan and equity capital for these purposes is severely restricted. Funds that are available command high rates. The present national fiscal policy has contributed to this situation,

although it did not in itself create it. It has become increasingly evident in recent years that the Canadian money market is unable to accommodate the growth demand of the real property industry. Major project builders have been required to seek out foreign capital in order to complete Canadian projects. Economic forces abroad have now placed constraints even on these sources of supply. Erosion of interest income due to inflation, higher effective income tax on interest compared to dividend income, competition from alternative opportunities, and a reduction in the supply of funds normally available from major institutions due to excessive demands made upon them from other sources, have together seriously curtailed the supply of loan capital both to the real estate industry generally and to our company in particular.

The combined impact of inflation and high tax rates have proved to be a serious deterrent to the flow of mortgage and loan funds. Consider for example the position of a prospective investor in a mortgage whose marginal income tax rate is 50%, and who is able to obtain an interest rate as high as 12% on his investment. This interest would be reduced to 6% by income taxes and inflation at its present level would erode the value of his capital invested by about 5% per year, with the result that the investor's actual yield would only be 1%. Loan capital is essential to the economic health of the real estate industry and when this flow is obstructed, as it is at present by such factors, investors turn to more promising opportunities.

The implications of a reduction in equity investment (or "seed capital") in real property are even more serious. An initial equity investment in property, when combined with appropriate mortgage financing will support a total investment in real estate some three to six times the size of the original equity capital involved. (The investor providing the mortgage financing looks to the initial capital provided by the equity investor to provide the risk investment or buffer against loss to protect his mortgage security.) A reduction in the supply of equity capital coming into the real estate industry will result in a significantly greater reduction in total investment: every dollar lost in initial financing can mean a reduction of up to six dollars or more in total investment in the field.

These factors have already contributed significantly to the 37%* decrease in housing starts in the Metropolitan Toronto area during the last quarter of 1969, compared with the same period for 1968, a trend which is expected to continue in 1970.

At a time when Canada is in need of continuing real estate development, particularly in the area of residential accommodation, and when this development is already being hindered by existing economic conditions, the introduction of legislation which would effectively retard such development further seems unwise and contrary to the best interests of the country.

We believe that certain of the proposals contained in the White Paper on tax reform would, if enacted, result in a decrease in the amount of equity capital invested in the real estate industry and thereby cause a significant decline in new commercial and residential construction in Canada.

E. WHITE PAPER PROPOSALS DIRECTLY AFFECTING SUPPLY OF REAL ESTATE DEVELOPMENT CAPITAL

I Limitation on deduction of capital cost allowances:

The White Paper proposes that a taxpayer be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance.

1. The present capital cost allowance provisions of the Income Tax Act are designed to allow the taxpayer to deduct from his income over a period of years the cost to him of an income-producing asset. The deductions, in total, are limited to the cost of the asset, and once they reach that total they cease. In addition, if the taxpayer sells an asset for an amount greater than its undepreciated capital cost, he becomes taxable on the full amount of the excess, at least up to the amount of capital cost allowances previously claimed.

The present provisions of the Act, therefore, protect the Revenue against excessive deductions for capital cost allowance.

* - Statistics published by Central Mortgage and Housing Corporation.

2. It is interesting to note that in the United States it is possible in certain situations not only to claim full depreciation on real property, but to regard some or all of the depreciation recaptured on disposal of the property as a capital gain, which would then be taxed at a lower rate. If the Canadian treatment of real estate developers becomes very substantially less favourable than their treatment in the United States, Canadian real estate development would no longer be able to attract United States investors, who constitute an important source of capital. Even with the recent amendments to the U.S. tax laws, an investor in real estate in the U.S. will have substantially more favourable treatment than an investor in Canadian real estate under the White Paper proposals.

3. There is a tendency in some quarters to regard capital cost allowance or depreciation as an 'artificial' expense because it does not require a yearly outlay of cash. Depreciation is an actual portion of a cost incurred by a business, i.e., the purchase of an income-producing asset, which it would not be reasonable to regard as an expense of only the year in which it was incurred. Depreciation, then, is a 'real' or actual expense, and together with initial high interest and low revenue in a real estate development, can create a 'real' loss which is incurred in the hope that it will lead to future profits. It seems to us that a loss incurred by claiming capital cost allowance on a half vacant apartment building is no different than a loss incurred by a manufacturing business through claiming capital cost allowance on a half vacant factory building.

However, no restrictions are proposed on losses incurred by other than real estate businesses, so that the manufacturing business would be able to deduct the "loss" created by claiming capital cost allowances on assets in excess of the income produced therefrom while the apartment building owners would not. To take one further specific example, a business purchasing a building for use as a retail store would be able to claim full capital cost allowances thereon, even if purchased late in the company's fiscal year and even if the building were not used in that year, while an investor in rental housing would be effectively prevented from doing so.

4. The restriction on the deductibility of losses, together with the increased advantages of portfolio investment due to integration, will draw equity capital away from real estate, thus retarding the construction of new housing and commercial buildings.

5. An investment in real estate development is generally of a long-term nature and often yields a low cash flow. The present rate of inflation and the uncertainty regarding its future effect on the economy tends to further diminish the attractiveness of long-term investments, thereby restricting the ability of the real estate development industry to attract new equity capital; the White Paper proposals would further decrease the attractiveness of the industry.

Recommendation:

We recommend that there be no change in the present income tax legislation regarding the deductibility from other income of losses created by capital cost allowances. If the government has serious objections to this recommendation, we suggest that, in the interests of equity, companies whose chief business consists of real estate development (or a closely allied field) be permitted to deduct such losses from all other income usually associated with that type of business, such as rentals, land sales, interest on mortgages taken back on land sales, etc.

II Separate capital cost allowances classes:

The government proposes that each building costing over $50,000 be placed in a separate class for capital cost allowance purposes.

We appreciate that under the present legislation, which allows all buildings to be placed in the same class, there is a possibility of deferring for some time taxes which might otherwise be payable as a consequence of recapturing depreciation on the sale of a building. However, we point out that most real estate development companies are in the business of constructing buildings which will be held indefinitely by the companies as a source of rental income. Although sales of rental buildings on which capital cost allowance has been claimed may occur from time to time, such sales are relatively infrequent

and do not form an integral or significant part of real estate development companies' business. Such companies therefore do not take unfair advantage of tax deferral benefits available under the present legislation in connection with the recapture of depreciation.

While, for the reasons outlined above, we are not unalterably opposed to the government's proposal, we suggest that consideration be given to the following modifications:

(a) That the proposal not apply to companies whose chief business is real estate development

(b) That the cost of new buildings to be placed in separate classes be raised to a figure substantially higher than $50,000.

III <u>Limitation on Deduction of Interest and Realty Taxes</u>:

The Government proposes that a taxpayer be prohibited from deducting from other income a loss from holding property if that loss was created by interest and realty tax expenses. Although the White Paper does not deal further with this subject, we assume that such losses would be available to reduce capital gains subsequently realized on the sale of the relevant property.

1. Companies in the real estate development field find it necessary to assemble large areas of land frequently many years prior to the commencement of actual operations. This permits comprehensive and long term planning which is essential if the new communities are to present a healthy social environment. It is also more efficient and economical than the small single-property development, and is probably the only way that such companies can provide large planned residential developments at reasonable cost.

2. Companies which are in the process of assembling and/or developing large land areas inevitably incur interest and realty tax costs which are in excess of the income derived from the undeveloped or partially developed land.

3. Interest and realty taxes incurred in holding land for development represent a cash outlay and it is therefore difficult to justify prohibiting or limiting their deductibility. We note that the White Paper does not propose to prohibit distilleries from deducting current interest on funds borrowed to hold inventories of liquor for aging and future consumption. Why is the holding of real estate for future development to be singled out for substantially worse treatment?

4. The effective disallowance of legitimate expenditures incurred by development companies would prove particularly inhibiting to large scale development projects where the disallowance would, as a practical measure, be particularly effective. This in turn would create an unfortunate bias against large residential developments planned on an orderly and proper basis.

5. Losses resulting from interest and realty tax expenses are experienced mainly in the early stages of a development when rental revenues are low. These losses are effectively establishment costs, and in many cases represent initial high vacancy rates, problems of renting, etc. There is no similar restriction on the establishment costs of companies in other industries. If a tobacco company, for instance, is allowed to deduct a loss incurred in establishing a new brand of cigarettes, why should a real estate company be prohibited from deducting losses incurred in establishing a new housing development?

6. Since companies in other industries would not be subject to restrictions on the deductibility of losses and would be able to continue to offset losses from one source against income derived from another source, investment in other industries would become more attractive than real estate investment and would result in a further decrease in the supply of equity capital available for real estate development.

Recommendation:

We recommend that losses created by interest and realty taxes continue to be allowed as a deduction against other income, or alternatively as a minimum modification of the proposals necessary to prevent very substantial

inequities which would otherwise be created, that companies whose chief business is in the real estate development industry be permitted to deduct such losses from all other income usually associated with that industry.

F. OTHER PROPOSALS

I Elimination of deductions for convention and entertainment costs:

1. Most conventions are held for legitimate business reasons. Their main purpose is generally to convey to the participants new or improved management, production, or sales techniques, policies, procedures, etc. Company conventions also give employees from various parts of the country an opportunity to meet each other and to discuss common problems. This leads to increased cooperation and co-ordination of efforts among these employees, to the ultimate benefit of the company. Industry conventions not only expose the participants to new methods and techniques, but also provide an opportunity for new business contacts to be made.

2. Many conventions are held in smaller, sometimes even remote areas where local businesses derive substantial benefits from the visitors or may even be dependent on their patronage to survive. A loss of conventions could have serious effects on the economics of these communities. In many such areas compensating opportunities are difficult to establish due to lack of labour force, market or natural resources.

3. Conventions and business entertainment stimulate retail trade, which in turn increases government revenues in the form of sales and income taxes.

4, Abolition of convention and entertainment deductions would lead to a decrease in such expenditure and a tendency to centralize conventions in large cities. This in turn would cause:

(a) Economic hardship for businesses and individuals in smaller communities

(b) A decrease in trade for all businesses in the entertainment industry

(c) An increase in unemployment as entertainment/convention business falls off.

This effect will probably be felt more in smaller communities and remote areas where alternative employment is more difficult to find. The problem of normal off-season unemployment in these areas would be aggravated, particularly as conventions are often held in off-season periods.

5. Attendance at conventions gives participants an opportunity to visit parts of Canada that they might not otherwise see, and to better appreciate the problems and viewpoints of the people of these areas. This in turn promotes a greater feeling of national unity amongst persons who live in diverse areas of the country.

6. While it may be that the provisions for deductibility of entertainment and convention costs are sometimes abused, we feel that the Government's proposals are unnecessarily severe.

7. We suggest that the increase in tax revenues achieved by disallowing costs of even domestic conventions might be very substantially offset by the loss of sales and income tax revenues to federal and provincial governments from persons in the convention/entertainment industry.

8. It seems to us that the present system of conventions and entertainment expense deductions, always subject to the watchful scrutiny of the Department of National Revenue, is operating on a reasonable basis. The White Paper's proposals would seek to stop the abuses by arbitrary and punitive means, which would have the effect of reducing the incomes of the whole host of modest income earners who through employment in the industry rely to a significant extent on the convention industry for their livelihood.

Recommendation:

We recommend that entertainment and convention costs continue to be allowed as deductions within reasonable limits, and that appropriate guidelines be established, or if necessary, legislation be introduced defining those limits.

II <u>Capital gains - Effect on Principal Residences</u>:

The Government proposes that a capital gain realized on the sale of a taxpayer's personal residence would be reduced by $1,000 for each year of occupancy and by the greater of total home improvement costs or $150 per year, or under certain circumstances, that it would be applied against the cost of acquiring another residence.

1. The allowance of $1,000 per year is undoubtedly inadequate for many taxpayers, especially those whose homes are in urban areas experiencing rapid growth such as Toronto. This allowance may well prove to be inadequate to prevent many owners of relatively modest size homes from paying tax on essentially inflationary gains.

2. The "rollover" provisions for deferring recognition of gains on homes proposed in the White Paper are too limited. The provisions fail to recognize that an individual does not necessarily change his principal residence only when he changes his job. A taxpayer who is industrious and obtains promotions in his employment may find that his residence is no longer appropriate for someone in his position. People also change residences because of increases in the size of their families, or just because they find a house that they would prefer over their present one. There are many legitimate reasons for changing residences, yet the "rollover" provisions would apply only where a change in employment involving both a change in job location and a change in residence is involved.

3. A taxpayer who is not able to take advantage of the rollover provisions on the sale of his residence could be liable for tax on the gain at a rate much higher than his normal marginal tax rate. The averaging proposals are too restrictive to provide adequate relief in such a situation.

<u>Recommendation</u>:

We recommend that a capital gain realized by a taxpayer on the sale of his principal residence be exempted from income tax.

G. NEED FOR INCENTIVES

A problem associated with the supply of capital for real estate development arises from the fact that most mortgages are for a fixed amount and are of a long term nature, and the interest income is at a fixed rate over the period of the loan. The investor in mortgages commits his capital for a number of years, and is therefore powerless to prevent his investment and the income it produces from being eroded by inflation. He is also unable to liquidate his investment if he should require the capital for other purposes.

The investor in equities, on the other hand, has almost complete flexibility of investment, and is able to switch investments to take advantage of opportunities that may arise; his capital is not committed for long periods of time. The value of equities generally moves in concert with inflation and dividend income from such investments is accorded preferential tax treatment. These factors tend to make investment in mortgages less attractive and have led to the critical shortage of loan capital which is presently threatening to seriously undermine the real estate development and construction industries. We have already pointed out the alarming decline in residential construction in 1969, a decline which shows no signs of abating. We believe that because of the obviously damaging consequences of a continued shortage of loan capital which implementation of the White Paper proposals will further aggravate by encouraging investment in common stocks, the Government should give serious consideration to instituting incentives for investors in fixed debt securities such as mortgages.

One possibility is an incentive in the form of a deduction from a mortgagee's taxable income in an amount equal to the erosion of his investment through inflation. This erosion could be determined by reference to the consumer price index.

A second incentive that would stimulate the flow of loan capital and at the same time provide an opportunity for small investors to participate in real estate investment, could be made available through the creation of tax free "trusts" similar to the Real Estate Investment Trusts provided in the United States. Such "trusts" are exempt from income tax on income distributed to shareholders, if their real property assets and income represent a specified

percentage of their total assets and income, and if at least 90% of their income is distributed to shareholders. The shareholders themselves are, of course, subject to income tax on amounts distributed to them by the trust. These provisions recognize the need for incentives to make possible the gathering together of large pools of capital monies which must exist before major real property developments can commence. The shares of these "trusts" would be widely traded thus preserving for the small investor a liquidity which he otherwise would not have.

In the United States incentives are also available to an individual mortgagor in that he is able to deduct mortgage interest from his personal income. While this might have little direct effect in encouraging loan funds into the industry, it would at least help home owners afford the high interest rates that prevail at the present time.

Recommendation:

We ask that serious consideration be given in the tax reform proposals to the creation of incentives along the lines briefly described above to encourage the flow of loan capital into the real property industry.

APPENDIX "D"

NAME: MARKBOROUGH PROPERTIES LIMITED

SUBJECT: Capital Cost Allowance and Other Expenses re Rental Income

Analysis of Appendix "C" by Senior Advisor

This brief is submitted by a company whose shares are listed on the Toronto Stock Exchange and owned by over 2,000 shareholders, none of whom owns more than 10% of the outstanding shares.

The company owns over $56 M of developed and undeveloped real estate in five urban areas across Canada.

The brief refers to the following White Paper proposals:

(a) The limitation of deduction of capital cost allowance. (Pages 5 to 7 of the Brief)

(b) Separate classes for each building costing over $50,000. (Pages 7 and 8 of the Brief)

(c) Limitation on deduction of interest and realty taxes from rental income. (Pages 8 to 10 of the Brief)

(d) Elimination of deduction for convention and entertainment expenses. (Pages 10 and 11 of the Brief)

(e) Capital gains tax imposed on proceeds of sale of principal residence. (Page 12 of the Brief)

(f) Need for tax incentives. (Pages 13 and 14 of the Brief)

In summary, Page 1 of the brief states that the proposal for tax reform would restrict the accumulation of investment capital. Again on page 3, the brief states "The implementation of the White Paper will result in a decrease in the supply of capital, and a diversion of the remaining available capital from fixed debt investment and investment in growth equities to investment in mature equities."

The brief recommends:

(1) That no changes be made to the present provisions of the law respecting the amount of capital cost allowances, interest or property taxes that may be deducted from rental income.

(2) That reasonable amounts of convention and entertainment expenses continue to be allowed as deductions.

(3) That no capital gains tax be applied to any gain realized on the sale of a principal residence.

(4) That consideration be given to the creation of tax incentives to provide capital for real estate development.

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: MARKBOROUGH PROPERTIES LIMITED

Date Brief Received:

Principal Subject: Capital Cost Allowance
(A) Limitation on Deduction

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act permits a taxpayer to deduct capital cost allowances within limits, irrespective of whether or not a loss results from such deduction.	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	Page 5 of the Brief The brief points out that the present provisions of the Act, protect the "Revenue" against excessive deductions for capital cost allowance. Page 6 of the Brief The brief points out that under specified conditions in the United States "recaptured depreciation" is treated as a capital gain. The brief points out that it is incorrect to regard a capital cost allowance as an "artificial" expense because it does not require a yearly outlay of cash. Page 7 of the Brief The brief recommends that no change be made from the present income tax legislation respecting losses created by capital cost allowances.

Name: MARKBOROUGH PROPERTIES LIMITED

Date Brief Received:

Principal Subject: Capital Cost Allowance
(B) Separate classes of Depreciable Assets

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act and Regulations require that assets be segregated into pools or classes of assets and does not provide for any further segregation.	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	Page 8 of the Brief The brief states its opposition to the proposal to create separate pools of assets for buildings whose cost exceeds $50,000. It suggests that consideration be given to (1) the non-application of the proposal to companies whose chief business is real estate development; (2) raising the proposed figure of $50,000 to a substantially larger amount.

Name: MARKBOROUGH PROPERTIES LIMITED

Date Brief Received:

Principal Subject: Limitation on Deduction of Interest and Realty Taxes

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
No similar limitation is imposed by the Income Tax Act, other than that the expense must be incurred in the process of earning income and must be reasonable in amount.	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	Page 8 of the Brief The Brief points out the need to assemble large areas of land frequently many years before the commencement of actual operations. Page 9 of the Brief The Brief states that such a limitation would inhibit large-scale development projects. The Brief recommends that these proposals should not be implemented.

Name: MARKBOROUGH PROPERTIES LIMITED

Date Brief Received:

Principal Subject: Convention and Entertaining Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act permits the deduction of convention expenses and entertaining expenses of reasonable amounts. Section 12-2 of the Income Tax Act permits the tax collector to restrict claims of unreasonably large amounts of expenses.	2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.	Page 11 of the Brief The Brief recommends that entertainment and convention expenses continue to be allowed as deductions within reasonable limits.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	

Name: MARKBOROUGH PROPERTIES LIMITED

Date Brief Received:

Principal Subject: Capital Gains – Principal Residence

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act contains no provisions to tax capital gains.	3.18 As stated, all or part of the capital gain would be treated as income, depending upon the type of asset involved. The general rule would be that capital gains would be fully taxable. However, special rules would be provided to reduce the tax in the case of a taxpayers' principal residence, other property held for personal use or enjoyment, and shares of widely-held Canadian public corporations. Special rules would also reduce the tax on the sale of bonds and mortgages which are held on the day this White Paper is published. These rules, and the special rules concerning losses, are explained in the following paragraphs.	Page 12 of the Brief The Brief points out: (1) that the allowance of $1,000 per year of occupancy is inadequate; (2) the "rollover" provisions are too limited; (3) the averaging provisions are too restrictive to provide relief to those unable to take advantage of the "rollover" provisions. The Brief recommends that any tain realized on the sale of a principal residence be exempted from tax.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	3.19 Generally, capital gains on the sale of homes would not be taxed. This would be accomplished by providing that when a taxpayer sells his principal residence only the profit in excess of $1,000 per year of occupancy would be taxed, and by granting the "rollover" discussed in the next paragraph. Both of these provisions would of course apply on the sale of a farm with farmhouse that has been a principal residence. The $1,000 per year exemption would also compensate for the fact that losses on the sale of a taxpayer's residence other than a farmhouse sold with the farm, would not be deductible from income for tax purposes. The government believes it would be virtually impossible to distinguish between losses which arise from changes in the real estate market and losses which arise from the aging of the house and normal wear and tear. Naturally in calculating his profit the taxpayer would be able to take into account the cost of the improvements he has made. If he does not bother to keep records, he would be allowed instead a home improvement allowance of $150 per year of occupancy.	

Name: MARKBOROUGH PROPERTIES LIMITED

Date Brief Received:

Principal Subject: Incentives

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
No provisions exist in the Income Tax Act to encourage the investment in property mortgages.	There are no comments upon this subject in the White Paper.	Page 13 of the Brief The brief points out the need for incentives to provide capital for real estate development. A suggestion is made that consideration be given to the creation of tax-free trusts created to provide capital for real estate development.

APPENDIX "E"

THE BUDD AUTOMOTIVE COMPANY OF CANADA LIMITED

DRAFT OF LETTER TO
FINANCE MINISTER BENSON
GOVERNMENT OF CANADA

A most difficult job is that of guiding new tax legislation through the myriad obstacles that can be put in its path. You are to be congratulated, for not only have you chosen the more difficult path, in presenting tax reform as a White Paper rather than draft legislation, but you have made yourself available, often under trying circumstances, to foster debate. Without doubt, your approach has helped remove any "sacred cow" connotations, increased interest, and sparked healthy controversy among the Canadian people.

Our company did not exist four years ago and we were created in Canada because of the economic atmosphere. Presently we employ approximately 750 people, with wages and salaries paid of over $6 million in 1969, resulting in employee income tax deductions of over $1 million. Last year our total purchases exceeded $17 million, with over $8 million in steel alone bought from Canadian steel mills. Due to a $40 million expansion programme, by 1971 we will employ approximately 1, 500 people with a payroll in excess of $13 million, and total purchases of approximately $40 million. In addition, our company recently went public allowing the people of Canada to participate in our growth. With sales of around $65 million forecasted for 1973,

Draft of Letter to
Finance Minister Benson, Government of Canada

we will have had some impact on the economy. It can be stated unequivocally that this company would not exist today in Canada, if the proposals and principles contained in the White Paper were in effect.

Unfortunately, the people of Canada have been asked to evaluate an incomplete package. One must ask what effect changes in Capital Cost Allowance and Sales and Excise taxes will have on the individual and business when the recently changed estate tax laws and the White Paper are viewed as a package. It is inconceivable that you, as Minister of Finance, do not have some conception of changes to these pieces of legislation. Surely it is important, in fact imperative, that full knowledge of all proposals be put before the Canadian people so that the economic and social implications can be viewed in total. Your justification for a piecemeal approach of getting one item out of the way at any one time completely disregards that each item is part of the whole and, in fact, the adage that the whole is greater than the sum of its parts is most applicable.

Then too, comprehensive figures are unavailable to the public so that it is difficult, if not impossible, to measure truly the full weight of the White Paper on the Canadian economy.

21887—15½

Draft of Letter to
Finance Minister Benson, Government of Canada

In addition, the specific techniques of how the White Paper is to be implemented are not known, nor have many concrete comments regarding implementation been made by you or your Department. Surely such important factors must be made public and openly discussed.

One cannot argue that relief from hardship for those least able to cope or that the closing off of laws that have permitted high earners to unduly reduce their taxes are not valid objectives for our society. However, in the White Paper the means used to achieve these aims must be questioned. As an example, taxes have been reduced in one group and a higher tax level in other groups applied automatically. Thus the principle that tax reduction for one group must necessarily be accompanied by higher taxes for others is firmly established. Apparently, the alternative of trimming government spending rather than increasing the tax burden was completely disregarded. Certainly the voters will not have that choice! Public expenditures necessarily means a diversion of resources from private consumption and investment, and again the government has implied its omnipotence in making the "public expenditure" choice.

Draft of Letter to
Finance Minister Benson, Government of Canada

Higher taxation affects the supply of capital as the effect on savings is substantial. Further, tax revenue is used mainly for current government expenses, thus higher taxation swings the pendulum toward present needs and away from future needs as served by capital.

Our tax system should interfere as little as possible with individual choice; i.e, there should be a minimum distortion of the choices which people are free to make. If one examines the implications of the White Paper proposals:

- on fully taxed private companies and half-taxed public companies;
- on small and family business;
- on the difficulties associated with the five year deemed revaluation;
- on tax favoured dividend earnings over, say, rental income;
- on housing construction;
- on householders who have to pay capital gains but cannot deduct capital losses; and,
- on the loss of incentive for lower income groups to "pull themselves up by the bootstraps" as well as the higher tax implications on other income groups,

one can readily see that the proposals for tax reform do not meet the criteria of neutrality, notwithstanding an announced aim of

Draft of Letter to
Finance Minister Benson, Government of Canada

the White Paper to be the promotion of economic growth and continued prosperity without having tax reform seriously interfere.

It is assumed by the writers of the White Paper that the average middle-and-upper income Canadian is materialistic and therefore a tax increase will not affect his desire to work. The rational goes something like this:

> Canadians have traditionally been hard workers and people who have "looked after their own". We, the government, will take on the job of looking after them (modern social needs?) and the cost will be higher taxes but reduced responsibility. The higher taxes will not stop people from working hard because they are materialistic and always want more. Therefore, the ultimate is achieved: a high progressive tax which gratifies a widespread sentiment against income inequality; everyone working harder than before but unable to accumulate wealth because of the tax structure and an all-powerful government continually expanding its base. Utopia!!

This rationale, in the eyes of independent and responsible Canadians, is false, undermining and corrupt.

Draft of Letter to
<u>Finance Minister Benson, Government of Canada</u>

Shall we examine this further: higher taxation lowers the real wage rate per hour of effort. When deciding between work and leisure one finds work less rewarding or leisure less expensive and therefore a person will substitute more leisure for work. If this substitution does not take place, a person must work more hours to regain his former income and scale of living <u>or</u> reduce his savings <u>or</u> negotiate a higher priced wage package. Such wage pressures are inflationary because they are not related to productivity and the net effect is to increase the price of labour in Canada, making us less competitive in world markets. A summary of the choices: more leisure, more work to attempt to get back to where we were, less savings, or inflationary pressures.

The choices do not seem particularly attractive, especially for a nation competing heavily in the export markets of the world and continually fighting inflation. Your comments seem to indicate that you believe none of this will happen to any significant degree, a remark which seems at best, naive.

Taxation performs an allocation function (from private to the public economy), a distribution function (transfer of private purchasing power), and a stabilization function

Draft of Letter to
Finance Minister Benson, Government of Canada

(to correct extremes of inflation or deflation). The key to the White Paper seems to be income distribution between income brackets and between geographical regions; transferring payments from those who save to those who spend. The social aspect completely dominates the economic aspect.

Thus, the social overtones of the White Paper are obvious. We believe that the average Canadian is not socialistically inclined. Certainly, the tradition of the country is being completely ignored. The government has not received a mandate for such sweeping changes in the social and economic fabric of Canada.

Additionally there appears to be enough difference between what is said and what appears to be actual (taking into account estate taxes and provincial taxing policies) to warrant further analysis and explanations. Taxation, and especially tax reform, must always be a matter of opinion, a matter of judgement, but surely after eight years of study and millions of dollars spent we can devise tax reform that will not discourage private companies from going public; that will not penalize subsidiaries of foreign companies that offered shares to Canadians; that will not penalize public companies with

Draft of Letter to
Finance Minister Benson, Government of Canada

excellent performance records but little or no creditable tax available for distribution. You have said that the White Paper on Tax Reform will be changed if good reasons for change can be produced. Without question, the proposals, if adopted, would retard capital formation (the very essence of our industrial base), change the outlook of our labour force, and contribute to inflation; but, perhaps most important, the tax proposals are not neutral, they interfere unduly with our free choice which, when all is said and done, is the very fibre of the Canadian structure. You have noted some "unworkable" sections, and there are more. Surely these obvious few bode ill for the dozens of other important implications. Therefore it seems reasonable that the White Paper be withdrawn and a revised edition presented, one that truly places taxation in Canada in a neutral position. This neutrality would serve the considerations of modern social needs to a far greater extent than artificial platforms placed by the present edition of the White Paper which if effected, will change the basic character of Canada for generations to come. The people will be changed from independent, responsible, hard-working, "look after your own" types, to a large mass of bodies completely dependent

Draft of Letter to
Finance Minister Benson, Government of Canada

upon a socialistic and welfare dispensing, benevolent government. They will have no opportunity and eventually no desire to improve their individual status quo. When the incentive and desire of an individual is removed, collectively the country will begin to die.

K-W RECORD March 6, 1970

REGISTER OBJECTIONS—Hundreds of Budd Automotive Co. of Canada Ltd. employees Thursday lined up after the afternoon shift to sign petitions objecting to Finance Minister Benson's white paper on tax reform. Petitions and briefs registering the objections will be sent to Prime Minister Trudeau, Finance Minister Benson and local members of Parliament. The petition signing had the company's blessings.

APPENDIX "F"

NAME: THE BUDD AUTOMOTIVE COMPANY OF CANADA LIMITED

SUBJECT: White Paper Proposals

Analysis of Appendix "E" by Senior Advisor

This brief is submitted by The Budd Automotive Company of Canada Limited and was endorsed by 499 of the company's 750 employees.

The Budd Automotive Company of Canada Limited was incorporated four years ago and became a public company in October 1969. Originally it was a wholly-owned subsidiary of The Budd Company, a United States corporation, which company is still the major shareholder.

The brief objects to the whole philosophy of the White Paper proposals but does not deal specifically with any of the proposals.

The attention of the Committee is drawn to the following comments in the Brief:

(1) It can be stated unequivocally that this company would not exist today in Canada if the proposals and principles contained in the White Paper were in effect. (Page 2 of the Brief)

(2) Unfortunately the people of Canada have been asked to evaluate an incomplete package. (Page 2 of the Brief)

(3) It is imperative that full knowledge of all proposals be put before the Canadian people so that the economic and social implications can be viewed in total. (Page 2 of the Brief)

(4) The specific techniques of how the White Paper is to be implemented are not known, nor have many concrete comments regarding implementation been made by the Minister of Finance of his Department. (Page 3 of the Brief)

(5) Taxes have been reduced in one group and a higher tax level applied automatically to other groups. (Page 3 of the Brief)

(6) The alternative of trimming government spending rather than increasing the tax burden was completely disregarded. (Page 3 of the Brief)

(7) Public expenditures necessarily mean a diversion of resources from private consumption and investment. Again the government has implied its omnipotence in making the "public expenditure" choice. (Page 3 of the Brief)

(8) Higher taxation affects the supply of capital as the effect on savings is substantial. Further, tax revenue is used mainly for current government expenses. Thus higher taxation swings the pendulum towards present needs and away from future needs as served by capital. (Page 4 of the Brief)

(9) Our tax system should interfere as little as possible with individual choice. One can readily see that the proposals for tax reform do not meet the criteria of neutrality. (Page 4 of the Brief)

(10) It is assumed by the writers of the White Paper that the average middle and upper income Canadian is materialistic and therefore a tax increase will not affect his desire to work.

This rationale in the eyes of independent and responsible Canadians, is false, undermining and currupt. (Page 5 of the Brief)

(11) A summary of the choices available to Canadians: More leisure, more work to attempt to get back to where we were, less savings or inflationary pressures. (Page 6 of the Brief)

(12) Taxation performs an allocation function (from private to the public economy) a distribution function (transfer of private purchasing power) and a stabilization function (to correct extremes of inflation or deflation).

The key to the White Paper seems to be income distribution between income brackets and between geographical regions: transferring payments from those who save to those who spend. The social aspect completely dominates the economic aspect. (Pages 6 and 7 of the Brief)

(13) Thus, the social overtones of the White Paper are obvious. We believe that the average Canadian is not socialistically inclined. Certainly the tradition of the country is being completely ignored. The government has not received a mandate for such sweeping changes in the social and economic fabric of Canada. (Page 7 of the Brief)

(14) Surely after eight years of study and millions of dollars spent, we can devise tax reform that will not discourage private companies from going public; that will not penalize subsidiaries of foreign companies that offered shares to Canadians; that will not penalize public companies with excellent performance records, but little or no creditable tax available for distribution. (Pages 7 and 8 of the Brief)

(15) It seems reasonable that the White Paper be withdrawn and a revised edition presented, one that truly places taxation in Canada in a neutral position. (Page 8 of the Brief)

(16) The White Paper, if implemented, will change the basic character of Canada for generations to come. The people will be changed from independent, responsible, hard-working "look after your own" types, to a large mass of bodies completely dependent upon a socialistic and welfare-dispensing benevolent government. (Pages 2 and 9 of the Brief)

There is no summary attached as no specific comments are offered respecting the White Paper proposals.

APPENDIX "G"

CONWEST EXPLORATION
COMPANY LIMITED

submission to

THE STANDING COMMITTEE ON BANKING, TRADE & COMMERCE

studying

PROPOSALS FOR TAX REFORM

Ottawa, Ontario

TABLE OF CONTENTS

TELEPHONE—(416) 362-6721
TELEX—02-29119
CABLES—CONWEST TORONTO

CONWEST EXPLORATION COMPANY LIMITED

TENTH FLOOR
85 RICHMOND ST. WEST.
TORONTO 1, ONTARIO

April 6, 1970.

The Honourable Salter A. Hayden,
Chairman,
The Standing Senate Committee on Banking,
Trade and Commerce,
The Senate of Canada,
Ottawa, Ontario.

Dear Sir:

We are pleased to have this opportunity to submit to your committee our views regarding the Government White Paper entitled "Proposals for Tax Reform".

Conwest Exploration Company Limited was incorporated in 1938 to consolidate the ownership of several mining properties in Western Canada and Alaska owned or controlled by Mr. Frederick M. Connell, O.B.E. and his brother W. Harold Connell and to carry on exploration in Western Canada and Alaska. Subsequently in 1944, the company was provided with additional finances and expanded its operations to become the principal exploration vehicle. The company is still controlled by the Connell family.

In the light of the accumulated experience of Conwest's management in the exploration field of mining, we have reviewed the provisions of the White Paper on Tax Reform. In our opinion, if written into law, the provisions of the White Paper will have an adverse effect upon the economic development of Canada and in particular, it will have a very adverse effect on the entire Canadian mining industry.

We oppose the idea that wholesale revision of The Income Tax Act is desirable. We believe that where changes in the Act are warranted, they can be accomplished by amending the existing act from time to time, thus retaining the maximum of statutory and case law with which taxpayers are familiar.

We are skeptical that equity in any tax structure is achievable. To isolate the Income Tax Act to achieve equity compounds the difficulty.

The Hon. Salter A. Hayden, April 6, 1970.

We submit that with respect to the mining industry the incentives now built into The Income Tax Act achieves in part neutrality against the bias inherent in the industry by reason of the extraordinary risks patent in its nature and the absence of incentives elsewhere in the tax structure which are provided to other industry.

We submit that capital gains tax is inappropriate in Canada at this stage in the Country's economic development. Particularly inappropriate is the proposal to tax certain unrealized profits every five years. If capital gains tax is deemed necessary we recommend that the rate should be half the rate applicable to income and not in excess of 15%.

We believe that the proposal to expose prospectors' gains to tax will result in hardship to the prospector out of all proportion to the revenue that will be derived.

Our views and our recommendations relating particularly to those portions of the White Paper proposals which we believe will have the greatest impact on this company and its shareholders are set out in the brief appended hereto.

Respectfully submitted,

CONWEST EXPLORATION COMPANY LIMITED,

C.R. Elliott, President.

CRE/ic.
Enc.

CAPITAL GAINS

The White Paper proposals with respect to the taxation of capital gains are an abrupt change not only from the present treatment but represent a radical departure from the tax treatment in countries which have traditionally included capital gains in the tax base. The Carter proposals with respect to capital gains included full inclusion of capital gains in income, liberal averaging provisions, full deductibility and unlimited carry-over of capital losses, and an immediate and drastic restructuring of progressive rates. The White Paper generally proposes full inclusion of capital gains in income while largely ignoring the other Carter recommendations.

There is a degree of uncertainty in the present law as to what constitutes a capital gain as distinct from an income receipt. Because capital gains have not been subject to tax, taxpayers have exercised their ingenuity in attempts to receive as capital gains what might otherwise have been received as income. This particular problem has centred around the build-up of corporate surplus. The government has periodically enacted legislation to counter these attempts and it is generally recognized that at the present time is equipped to prevent virtually all such avoidance attempts. There exists then both statutes and a vast body of case law to deal with the definitional problem of what constitutes a capital gain and what constitutes income. The White Paper, however, proposes the ultimate solution, that being full inclusion of capital gains in income. It should be noted that the argument that full inclusion of capital gains in income is necessary to prevent the transformation of income receipts to capital gains would no longer be valid since the White Paper integration proposals would largely solve the problem. For this reason, we believe that the government could tax capital gains separately.

There are some compelling reasons for retention of the present distinction between capital gains and other income with a preferential tax treatment for the former. The White Paper proposals like the Carter recommendations are predicated on quantitative considerations (so-called ability-to-pay). The qualitative aspects are ignored. Capital gains usually accrue over an extended period of time but are realized on an infrequent basis and thus full inclusion of a gain in the taxable income of one year and taxation at regular graduated rates is inequitable and virtually confiscatory. Part or all of capital gains are frequently money gains on inflated dollars which result neither in an economic gain nor in increased ability-to-pay. A tax levied on an inflationary gain is a tax on capital. Capital gains are part of the potential reward for risk-taking. Full inclusion of capital gains in taxable income would severely inhibit the flow of risk-taking capital investment which is essential for development of the Canadian economy.

It cannot be stated with certainty what the effects of full taxation of capital gains would have on our economic development. The government acknowledges that there would be a "modest" reduction in private savings but that improved "equity" more than counteracts this ill-effect. We believe that the effects could be much more deleterious than the government has acknowledged. Comparisons with the United States are inevitable, but it must be recognized that our economy is by no means as mature as that of the United States and we are a long way from achieving such economic maturity. To opt for a treatment of capital gains far harsher than the United States treatment is ill-considered.

Transitional provisions

Gross inequities could occur with respect to capital gains realized in the transitional period. Capital gains realized in the early years could be subject to marginal rates as high as 80%. Moreover, the benefits of the proposed averaging provisions, which are inadequate at best, would be severely limited in the early years. Furthermore, it would appear that averaging is limited to those circumstances where "income" rises over a period and that averaging-back would not be possible in circumstances where "income" dropped drastically.

Periodic revaluation

The reasons advanced in the White Paper for periodic revaluation are that:

- Shares of widely-held companies are readily marketable and the taxpayer can, therefore, realize his gain or loss at the time of his choosing.
- Revaluation would reduce the lock-in effect which might well otherwise occur.
- Revaluation would make it possible to classify more corporate reorganizations and mergers as tax free transactions.

While the proposal might reduce the so-called lock-in effect somewhat and might also facilitate more corporate reorganizations and mergers, we do not think these are important but we do believe that the validity of the first reason advanced is so highly questionable that complete rejection of the periodic revaluation proposal is warranted.

Prices established in free market activity are to a large extent determined by marginal buyers and sellers of securities. The marginal buyers and sellers are not only extremely flexible in the allocation of their investment funds among the various kinds of securities and alternative investments, but their buying and selling activity is a substantial proportion of the trading in the free market. These two characteristics of marginal buyers and sellers result in their overwhelming influence on security prices.

On the other hand, a large portion of the total capital stock outstanding is immobile as it is held as a basic part of the long-term investment portfolio of individuals and institutions including control investors and is unlikely to be sold regardless of short-term attractiveness. Thus, in many cases the market in a particular security is relatively thin and, therefore, responds dramatically to buying and selling pressure.

The prices of some securities are particularly volatile, usually reflecting the greater potential risks and rewards inherent in the activities of the corporation. Shares in mining exploration companies are a classic example of this market phenomenon. In most cases, irrespective of the dramatic short-term fluctuations in security prices, the underlying value of the security remains unchanged.

It is stated in the White Paper that "periodic revaluation...would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing". The holdings of the marginal buyer and seller of securities may well be readily marketable and he, therefore, can realize his gain or loss fairly easily at the time of his choosing. But since the marginal buyer and seller is not likely to be a long holder of a particular security, there is no need for periodic taxation of accrued gains and losses as these gains and losses will be realized fairly regularly. Large holdings of individual and institutional portfolio investors and control investors are not usually readily marketable and are certainly not any more so than is the case with many shareholders of so-called "closely-held" corporations. In many cases, the investor does not have the ability "to realize his gain or loss fairly easily at the time of his choosing". Indeed, in some cases he may be restricted by law from doing so. If such a shareholder were faced with liquidating a large part of his holdings, then it is extremely unlikely that he would realize the apparent gain or loss reflected by the quoted market value. Once it is recognized that shares of "widely-held" corporations are not necessarily readily marketable and that quoted market value is not necessarily indicative of the accrued gain or loss on an investment, then the concept of periodic revaluation must be rejected.

The proposed quinquennial revaluation of investment in shares of widely-held companies would pose a formidable obstacle to the maintenance of controlling blocks of shares over a period of several decades--let alone the lifetime of one individual or a group of individuals who own the controlling block. In spite of the statement in the White Paper "that for widely-held companies the link between shareholders and management is tenuous" there exist in Canada many companies which by definition would be widely-held companies where the link between shareholders and management is far from tenuous. This is the case with respect to Conwest and has been since the inception of the company.

In order to assess the implications of the quinquennial revaluation proposal for the controlling shareholders, a detailed study of Conwest has been completed on the basis of historical data. This study was to determine what the effect of the revaluation proposal would have been had the proposal been implemented into law on January 1, 1955.

The results of the study indicate that it would have been virtually impossible to maintain control of the company for more than two periodic revaluations.

- By the third revaluation, the control block would have shrunk from 59.2% of total outstanding stock to 47.8%.

- The economic cost of the tax to the individual shareholder can be much more than one-half of his personal marginal rate applied to the total gain. (Viz. for the period of three revaluations the economic cost of the tax varies between shareholders from 28.1% to 31.4%.) Moreover, further studies of a hypothetical model of a high yield, high growth

company indicated that over a term of five revaluations the economic cost of the tax (this includes taxes paid, dividends foregone on shares sold to pay tax, and growth foregone on shares sold to pay tax) could well approach or exceed 50%.

- The results of our study also indicate that serious horizontal inequities can occur as between shareholders in similar circumstances as a result of forces beyond their control. A combination of fluctuations in the market price of shares and the varying birth dates of shareholders can result in the periodic revaluation being more severe for some shareholders than others. The study indicated that the difference between the lowest and highest economic cost to a shareholder in the control group would have been almost 12%.

- One of the assumptions on which the study was based was that each shareholder could sell sufficient shares at the periodic revaluation price to pay his tax. To the extent that such sales would have realized more or less than the periodic revaluation price, the stated results of the study would have reflected more or less severe effects. This variable would be the source of further inequities as between taxpayers.

- Our study is predicated on the proposal that the maximum personal rate of tax would be approximately 50%. We think that however well intentioned the government may be at the present time towards effecting this, the need for increased revenue makes it unlikely that it will ever be realized. To the extent that in the future maximum personal marginal rates do in fact exceed 50%, the problems inherent in the periodic revaluation proposal would be further accentuated.

Our criticism of the five-year revaluation proposal has been confined to the areas of difficulty that the controlling shareholders of this company are likely to experience if the proposal were to be enacted. There are other areas of difficulty which were outlined in the recent position paper advanced by the Department of Finance. We believe that the problems cited in our brief and those outlined in the supplemental paper advanced by the Department of Finance are sufficiently valid as to justify the abandonment of this proposal as unworkable, inequitable, and highly damaging to the policy of Canadian corporate ownership.

Recommendations

(1) No unrealized gains should be subject to tax.

(2) The present distinction between capital gains and income receipts should be retained and realized capital gains be subject to a separate capital gains tax.

(3) Capital gains should be taxed at rates not exceeding more than 50% of the rates applicable to income and the maximum rate should not exceed 15%.

(4) In general, fair market value at valuation day should be the base for capital gains purposes. However, the taxpayer should have the option to elect to value his holdings either at the aggregate of their fair market value or the aggregate of their original cost.

(5) If capital gains are to be included in income, then the maximum marginal personal rates should immediately be reduced to 50%. In the alternative, it could be provided that gains realized during the gradual reduction period would not be taxed at a rate higher than 50%. Moreover, the more meaningful averaging provisions recommended in the Carter Report should be introduced.

(6) If capital gains are to be included in income, then the personal rates should be restructured so that the maximum rate would be reached at a much higher level. The Carter recommendation was that the top rate of 50% be achieved at the $100,000 taxable income level.

(7) Provision should be made in the integration proposals to place shareholders receiving capital gains through a corporation on the same basis as if they had realized such gains directly. The White Paper does contain such a proposal with respect to shareholders of mutual funds but this concept should be expanded to cover shareholders of other corporations.

(8) More generous roll-over provisions should be introduced. Where, for instance, a taxpayer exchanges property and the form of his investment changes though its nature does not, a tax-free roll-over should be allowed. This should be the case even if the taxpayer's relative economic interest in the property may be changed as a result of the transfer or exchange.

(9) Gains on sale of the principal residence of a taxpayer should not be taxed provided the "gain" is rolled over against the purchase of another residence. Further, a substantial once in a lifetime exemption on the gain on sale of the principal residence should be provided.

(10) Items of personal property acquired for personal use or enjoyment should be exempted entirely from capital gains tax.

(11) If capital gains are to be subjected to tax in whole or in part, existing estate taxes should either be abolished entirely or modified substantially.

PROSPECTORS' AND GRUBSTAKERS' EXEMPTION

The White Paper states with reference to the prospectors' and grubstakers' exemption:

> "For many years the act has continued a provision which specifically exempts from tax the proceeds received by a prospector or a grubstaker on the sale of a mining property. This provision was intended to make it clear that the government viewed this type of gain as a capital gain which under the existing system would of course be tax exempt. Under the new proposals capital gains are to be taxed and this exemption would therefore be repealed."

To view this proposal in its proper perspective, it must be realized that the annual "cost" of this incentive provision to the government has been negligible. To quote the Carter Commission study on the Taxation of Mineral Extraction:

> "Revenue foregone is difficult to estimate because the tax saving depends on the tax bracket of each individual. A rough estimate of the recent annual average payment to prospectors and grubstakers (not their tax savings) is that it is of the order of $1 million a year."

In addition, though the "cost" to the government has been minimal, the benefits to the government and the economy as a whole as a result of the successful activities of prospectors and grubstakers have been significant. It is our contention that the existence of the exemption has contributed substantially to this important activity.

It is our belief that the government bases this proposal on the principle of equity and a desire to achieve theoretical symmetry within the framework of the White Paper. However, we do not think it equitable that the results of the successful activities of a prospector or a grubstaker be equated with the results of the successful activities of, say, a real estate speculator or a stock market investor. The activities of prospectors and grubstakers are undertaken against overwhelming odds and involve a large degree of personal sacrifice to which most other taxpayers are not subject. Further, the occurrence of successful results is extremely variable (it would be most unusual for a particular individual to experience success more than once in a lifetime) and for this reason alone prospectors and grubstakers are deserving of special treatment.

The proposed deductibility for income tax purposes of the cost of acquiring mineral properties will not significantly benefit prospectors and grubstakers, nor will it give any significant benefit to the purchaser. This would be especially true if the purchaser has no income against which to deduct the acquisition cost or has no immediate prospect of generating sufficient income to enable him to do so. In these circumstances, the deductibility will be of no benefit to him and he will not be inclined to pay any more for the property

despite the proposed deductibility. In any event, the discouragement to the prospector is far more serious to the industry than whether or not the cost of property should be a deductible expense.

Transitional provisions

We are strongly opposed to the retroactive effects inherent in the proposed repeal of the prospectors' and grubstakers' exemption and the proposed deductibility of the acquisition cost of mining properties. Option agreements entered into prior to November 7, 1969 were negotiated in anticipation of the law remaining unchanged. If an option were to be exercised after implementation, it is proposed that the vendor will be taxable on the full proceeds or on some portion of the proceeds (ranging from 60% to 95%). It is proposed that the purchaser would be entitled to deduct for tax purposes the full purchase price. If these options had been negotiated in anticipation of the government's proposals, the consideration would probably have been revised substantially leaving both parties in relatively equitable positions. As proposed, the prospective purchaser (the optionee) would be put in a much better after-tax position at the expense of the prospective vendor (the optionor). It would also appear that any exploration and development expenditures incurred by the individual prospector or grubstaker prior to implementation date would not be relevant in determining the net amount subject to tax on the disposition of the mining property. This would further compound the gross inequity to the prospective vendor.

Technical considerations

If the government is to repeal the prospectors' and grubstakers' exemption, it is imperative that recognition be given to the unique aspects involved in the purchase and sale of mineral rights. The "value" of a particular mineral property can only be established by profitable operation or abandonment. Frequently, properties are transferred in the early stages of exploration when the value of the property is unknown and thus the purchase consideration is typically a small amount of cash and a share interest. Also typically, the vendor's share interest is escrowed until such time as the consent of governmental regulatory bodies (i.e. provincial security commissions) is forthcoming. At the time transfer of a property takes place, the vendor's "ability-to-pay" usually has not increased nor has the amount of his "gain" or "loss" been determined. It would, therefore, be unreasonable to impose any tax at this point in time. Provision should be made for a tax-free "roll-over" on the transfer of a mining property when the consideration is non-cash.

The proposed quinquennial revaluation of shares of widely-held companies would be a further source of inequity to the prospector and grubstaker. If shares of widely-held companies are subject to escrow arrangements, then not only is quoted market value particularly inappropriate to determine their value but their marketability is severely limited. If the proposed quinquennial revaluation were to be applicable to such shares, the prospector and grubstaker would be severely discriminated against relative to the holder of freely marketable shares in widely-held companies.

Recommendations

(1) The prospectors' and grubstakers' exemption should be retained.

(2) If, however, the exemption is to be repealed, the prospector or grubstaker should be protected by a tax-free roll-over on the transfer of mining properties with no tax being exigible until such time as cash is realized through the sale of the vendor's shares. In addition, the more generous block averaging provisions recommended in the Carter Report should be introduced.

THE PRESENT INCENTIVES TO THE MINING INDUSTRY

The Carter Report stated that the existing incentives are unnecessarily costly, inefficient, and violate the principle of allocative neutrality.

That Report contended that an appropriate measure of the cost of the existing incentives is the tax revenues foregone in the presence of such incentives. We firmly believe that to consider the "cost" of the incentives to the government treasury to be tax revenues currently foregone is extremely misleading. It is illogical to include in this "measure of cost" tax revenues foregone on projects that would never have taken place in the absence of such incentive provisions. What course of development would the mining industry in Canada have taken in the absence of such incentive provisions? Had these incentives not existed, we believe that much of the growth in the mining industry would have been inhibited and that the loss of revenue, not only from the failure to obtain tax directly from operations that would not have materialized but also from the economic impact and the loss of taxes on payrolls, purchases, and dividends that have been the result of the establishment of profitable mines, would have greatly exceeded the relatively small "cost" of the incentives.

That Report contended that existing incentives are inefficient because they reward projects that would have taken place in any event. These incentives reward success, and this is their fundamental appeal. It is because the incentives reward all successful ventures without discrimination that they have proven an extremely powerful stimulus to the development of the mining industry.

That Report contended that the incentives violate the principle of allocative neutrality. It states that in the absence of induced incentives the "market place" would decide the appropriate allocation of capital to all the private sector and that if under neutral conditions investment in natural resource development were not as attractive as investment in other industry then investment in natural resource development would be shifted to investment in other industry. We reject this premise and contend that capital now devoted to natural resource development in Canada would flow to natural resource development elsewhere if Canadian resource development returned sub-marginal rates of return after tax. Canada is not the

only country in the world with favourable geology and the other non-tax factors which are attractive to investment in the development of natural resources. To the extent that tax or other incentives are not competitive with those in other countries, all other things being equal, a reduction in this type of investment capital can be expected with no corresponding shift of resource oriented capital to investment in other industries. Indeed, we contend that "allocative neutrality" is established by existing incentives which tend to correct the bias created by the extraordinary risk inherent in resource exploration and development. It should be noted that other Canadian industries are provided powerful incentives through protective tariffs, subsidies, and other fiscal measures.

The White Paper proposes to abolish the existing incentives of the three-year exemption for new mines and percentage depletion allowance and to replace them with a provision for quick write-off of direct expenditures in bringing a new mine into production and the earned depletion provision. It is stated in the section of the White Paper dealing with economic effects that:

> "The changes proposed in the special rules applying to the mineral industry would have some effect in reducing the expected rate of return..."
>
> "...The overall effect on the development of new mines cannot be forecast with any certainty (emphasis added); it would probably depend on general attitudes as well as on calculations. We do not expect it to be serious..."
>
> "The extra inducement offered in the mineral industry through the 'earned depletion' and the immediate write-off of capital costs of new mines should continue to attract capital from Canadian sources and abroad in competition with the resources and investment conditions offered in other countries."
>
> "All in all, the mineral industries would continue to be stimulated by some tax measures not offered to other industries, but not to as great a degree as under present law."

We do not agree with this assessment of the economic consequences to the mineral industry. We believe that mining exploration will be sharply curtailed and as a result the growth rate of the mining industry in Canada will decline significantly if these proposals are enacted into law. We draw attention to a study by the Institute of Quantitative Analysis of the University of Toronto on the economic effects of the Carter Commission proposals vis-a-vis the mining industry which was commissioned by the Department of Finance. It concluded that the discovery rate of new orebodies would decline by from 33-1/3% to 40%, which would have "cut the growth rate of the industry from 5% annually to less than 3%." A decline of this magnitude would be very serious not only from the point of those directly involved in the mining industry and their suppliers but of all Canadians.

The assumption that despite the removal of incentive provisions approximately the same level of activity will continue and that therefore an increase in taxes will result is unsupported and unwarranted. The exact effect of the removal of existing incentives and their replacement by those proposed in the White Paper cannot be readily determined. However, it can be stated with certainty that the business incentive for investment and effort is the expected net return after taxes. If incentive is reduced, a reduction in activity and resulting taxable income will ensue.

The enactment of the White Paper proposals will result immediately in the curtailment of certain mining development projects. As the cash flow from existing mines is reduced by increased tax, there will be an immediate reduction in planned exploration programmes. Over the longer term, we believe that the reduced volume of after-tax cash flow from existing mines and the lower after-tax return on investment would continue to depress future activity in both exploration and development. The reduced level of exploration and development activity and the resultant reduction in the discovery of new mines will "cost" the Revenue far more through reduced taxable income from this source than the loss of revenue that would occur as a result of reducing mining income subject to tax under the existing incentive system and reduced revenue lost as a result of reduced payrolls, etc.

THE PROPOSED ELIMINATION OF THE THREE-YEAR TAX FREE PERIOD

> "The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation. It is recognized that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases. Consequently, special arrangements are desirable to ensure that the costs of exploration and development may be charged for tax purposes as early as possible in order that taxes will only be applied when it is clear that a project will be profitable" (emphasis added).

The government recognizes the fact that "special arrangements are desirable", but to ensure that costs will be deductible for tax purposes in order that "taxes will only be applied when it is clear that a project will be profitable" is no incentive nor does it reduce the risk. In the market place, exceptional risk demands an exceptional reward. The present incentives recognize this economic fact of life.

The three-year exemption of the production profits of new mines has been a major factor in the spectacular growth of the Canadian mining industry in the last three decades. It should be emphasized that this incentive is not merely a development incentive. Rather, it has provided a strong stimulus to the exploration

phase of mining activity upon which growth of the mining industry is dependent. The three-year exemption is usually closely connected in time with the exploration and the development stage of mining activity, and the reward is of limited duration. The incentive is profit oriented so that only profitable ventures benefit and unprofitable operations are not thereby subsidized. Most importantly, the reward has been sufficiently generous to have had a significant effect on investment decisions.

Recommendation

We recognize that there have been circumstances where because the mine has proven unusually profitable the amount of tax exempt income has been exceptional. We suggest that this situation, which we believe is responsible for most of the criticism of this incentive, would be corrected by limiting the tax exempt income to three years or recovery of invested capital whichever occurred sooner, at the same time retaining the right to capital cost and other deductions from taxable income provided in the present regulations.

DEPLETION ALLOWANCE

It is recognized in the White Paper that "corporation income taxes are already high by international standards; further increases would be damaging to our economic development and competitive ability, making it more attractive to locate industries in other countries." We believe that the overall effective rate of tax on mining income is material to tax reform.

The present percentage depletion allowance operates to reduce the effective rate of tax, including provincial mining taxes, below the average rate of 52% levied on other Canadian industries. The proposed repeal of the percentage depletion allowance would result in an overall effective rate of tax on mining income (before "earned depletion") varying from 57% to 60% as compared to the 50% rate proposed for other Canadian industries. If 10% of before tax income has been expended on eligible exploration expenditure, the application of "earned" depletion would reduce the effective rate by only approximately 1½ percentage points. However, the proposal to allow "earned depletion" is sufficiently ambiguous and may be capable of such a narrow interpretation that an overall assessment is difficult.

Canada's chief competitors for resource development levy preferential rates of tax on mining income through percentage depletion allowances and other like incentives. The taxes currently levied on mining income in Canada are competitive with those levied on our chief competitors outside of Canada.

If the White Paper proposals are implemented, not only would the Canadian mining industry suffer the competitive disadvantage of a higher effective

rate of tax than other Canadian industries but also the competitive disadvantage of a severely higher corporate rate than that levied on the mining industries of Australia and the United States.

Recommendation

So long as mining taxes and royalties are levied against mining companies by the provinces and the federal government in their respective jurisdictions, we can see no practical alternative to percentage depletion to maintain equity for the industry. We, therefore, can only recommend the retention of the percentage depletion allowance at the present rates.

INTEGRATION

The proposal to integrate corporate and personal income would reduce the double taxation of corporate source income and thus is to be commended. However, the mechanical and technical problems inherent in effecting such a system may be of sufficient magnitude to make it impractical. We believe that the present tax credit system has much to recommend it.

The White Paper does not propose any mechanism whereby the benefits of corporate tax incentives may be passed on to Canadian shareholders of mining companies whether corporate or individual. To the extent mining companies pay dividends out of income which has not been taxed by reason of incentive provisions, the benefit which the company has enjoyed will be "recaptured" in the hands of the resident shareholder in the form of higher taxes on the dividend income. It should be noted this will not occur with respect to non-resident shareholders as they would be subject only to a flat-rate non-resident withholding tax. This result seems highly illogical.

Recommendation

We recommend either that a flat rate credit on dividends be retained or that some mechanism should be provided to ensure that where corporate income is not taxed as a result of incentive provisions the benefits of the incentive provisions not be "recapturable" in the hands of the shareholder.

INDEX

APPENDIX A

CONWEST EXPLORATION COMPANY LIMITED

STATEMENT OF SOURCE AND APPLICATION OF FUNDS

For the period January 1, 1952 to December 31, 1968

APPLICATION OF FUNDS		
Direct exploration and development expenditures including those of subsidiary companies	$ 11,700,000	
Funds provided to other companies for exploration purposes	4,000,000	
General and administrative expenditures	1,900,000	
	$ 17,600,000	
Less Recovered from associated companies and other participants in exploration projects	3,400,000	
Net Expenditures on Exploration and Development		$ 14,200,000
SOURCE OF FUNDS		
Dividends from taxable Canadian corporations	$ 7,100,000	
Interest earned	1,200,000	
Sundry income	500,000	
Capital gains on portfolio investments	3,700,000	
	$ 12,500,000	
Less Dividends paid	2,800,000	9,700,000
DEFICIENCY IN WORKING CAPITAL BEFORE UNDERNOTED ITEM		$ 4,500,000
Gain on disposal of investment in Cassiar Asbestos Corporation Limited and United Keno Hill Mines Limited acquired as a result of exploration activities of Conwest for the most part prior to January 1, 1952		9,700,000
INCREASE IN WORKING CAPITAL FOR THE PERIOD		$ 5,200,000
Increase in Working Capital Applied to:		
Portfolio investments in other mining companies		$ 2,300,000
Short-term securities		2,900,000
		$ 5,200,000

APPENDIX B

SOME STATISTICS RELEVANT TO
CASSIAR ASBESTOS CORPORATION LIMITED

Taxes Paid Since Inception

Income taxes paid (federal & provincial)		$ 6,500,000
Federal Sales tax (estimated)		2,500,000
Province of B.C. taxes paid		
B.C. Mining tax	$ 3,700,000	
Property tax & retail sales tax (estimated)	1,200,000	
Gasoline tax (estimated)	600,000	5,500,000
Other provinces and/or territories		100,000
		$ 14,600,000

Salaries & Wages Paid (including head office)	$ 62,500,000

Sales	$230,500,000
Less Canadian Sales (estimated @ 3%)	7,000,000
Foreign exchange attributable to Cassiar Asbestos Corporation Limited	$223,500,000
Dividends Paid	$ 31,382,250

APPENDIX C-1

Assumptions re: Study of impact of quinquennial
revaluation on controlling shareholders of Conwest

1. Base price for capital gains purposes (V-day price) is the month end average for the 1954 calendar year, that is $3.375.

2. Implementation day is January 1, 1955.

3. Dividend policy of the company would have been similar to actual, that is $300,000 per annum.

4. All controlling shareholders would have been subject to the maximum personal marginal rate of 50% on the accrued capital gains as well as on their dividend income.

5. Controlling shareholders would have required all after tax dividend income for personal consumption and consequently would have been required to sell a portion of their holdings in order to raise sufficient funds to pay tax on the revaluations.

6. It is assumed that all holdings are fully liquid--that is any number of shares could have been sold at the quoted market value prevailing at any given revaluation date.

7. In order to determine the comparative effects as between shareholders in the controlling group, the quoted market value for the third revaluation is assumed to be $9.50 per share (being the year end close price December 31, 1968).

8. Brokerage charges on shares that would have been sold to pay tax have been ignored.

APPENDIX C-2

CONWEST EXPLORATION COMPANY LIMITED

Summary of study of impact of quinquennial revaluation on controlling shareholders of Conwest

	Accrued gain	Tax thereon	Shares sold to pay tax: Number of shares	Shares sold to pay tax: Percentage of total shares outstanding
Revaluation #1	$ 705,175	$ 176,294	40,192	1.61%
Revaluation #2	4,356,662	1,089,166	154,760	6.19%
Revaluation #3	3,403,294	850,819	89,454	3.58%
	$8,465,131	$2,116,279		
Number of shares that would have to have been sold to pay tax			284,406	11.38%
Number of shares owned by control group at beginning of system			1,479,800	59.19%
Number of shares that would have been owned by control group after three revaluations			1,195,394	47.81%

CONWEST EXPLORATION COMPANY LIMITED APPENDIX C-3

Summary of study of differental impact of quinquennial revaluation on shareholders in central group

Shareholder	No. of Shares beginning	No. of Shares after third revaluation	Shares sold to pay tax: No. of Shares	Shares sold to pay tax: Percentage of shares held at beginning	Economic cost of tax to Share-holder	Total tax burden as a percentage of lowest rate experienced
1.	81,100	64,915	16,185	19.96%	30.95%	109.97%
2.	46,900	37,711	9,189	19.59%	30.45%	107.93%
3.	524,000	421,376	106,624	19.58%	30.37%	107.88%
4.	348,400	282,914	65,486	18.80%	29.15%	103.58%
5.	130,600	106,902	23,698	18.15%	28.14%	100 %
6.	49,400	39,587	9,813	19.86%	30.81%	109.42%
7.	49,400	39,807	9,593	19.42%	30.15%	107.00%
8.	49,400	39,433	9,967	20.18%	31.35%	111.18%
9.	37,500	30,404	7,096	18.92%	30.89%	104.24%
10.	90,000	72,850	17,150	19.06%	29.56%	105.01%
11.	61,500	50,247	11,253	18.30%	28.38%	100.83%
12.	11,600	9,248	2,352	20.28%	31.44%	111.74%
	1,479,800	1,195,394	284,406			
	59.19%	47.81%	11.38%			

1. The economic cost of the tax to each shareholder is obtained by dividing the value of shares sold to pay tax (at the quoted price of $9.50) by what the total accrued gain would have been (i.e. $9.50 - $3.375 per share) if there had been no need to sell any shares.

Stated in another way this figure reflects the effective maximum personal marginal rate for each shareholder with respect to revaluation. This figure is twice the figure shown as the economic cost. In the example then the highest effective maximum personal rate would have been approximately 63% - 13 percentage points higher than the maximum 50% suggested in the White Paper.

2. The differntial of effective rates as between ~~as between~~ shareholders is caused soley by the factors of differing birth dates and by market fluctuations.

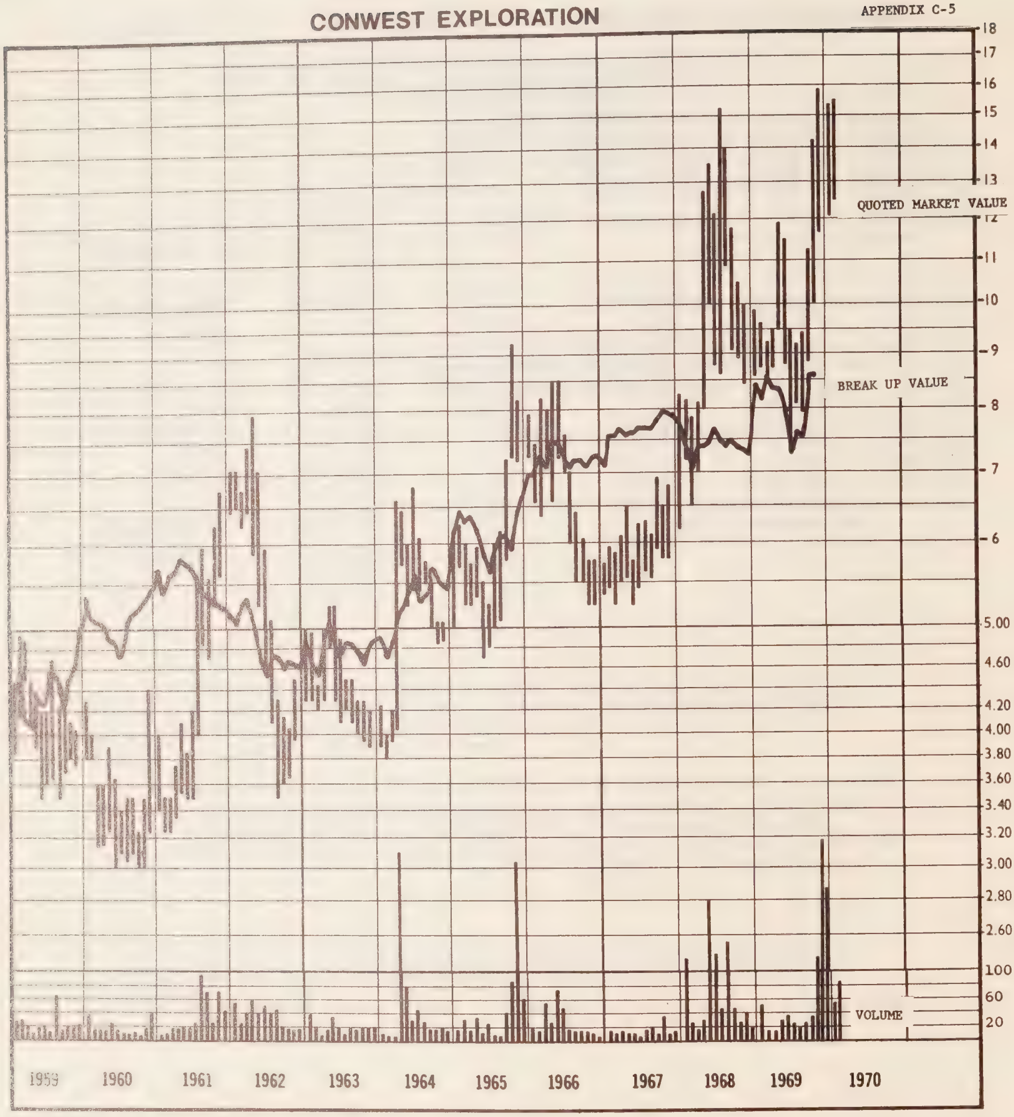
CONWEST EXPLORATION COMPANY LIMITED

Appendix C-4

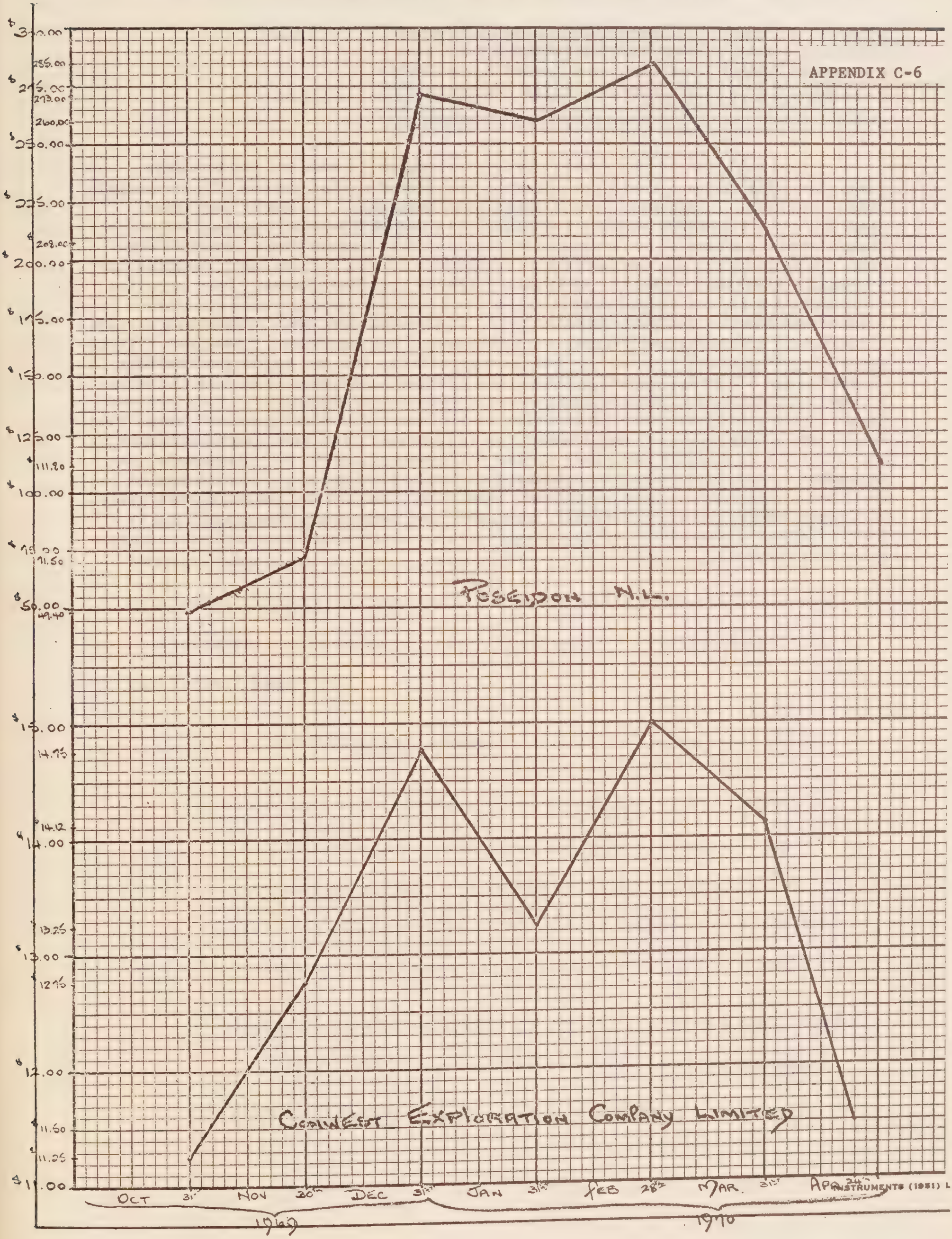
Comparison of net after tax dividend income that would have been received by control group of shareholders with the capital gains tax that would have been payable on quinquennial revaluation for the period 1952-1968

Total dividends paid	$2,850,000
Dividends paid to control group	$1,510,000
Less Income tax thereon (assuming full creditability and that all shareholders in control group are subject to a marginal personal rate of 50%)	377,500
Net after tax dividend income	$1,132,500
Income tax that would have been payable on revaluation (See Appendix C-2)	$2,116,279

APPENDIX C-5


CONWEST EXPLORATION
18
17
16
15
14
13
QUOTED MARKET VALUE
12
11
10
9
BREAK UP VALUE
8
7
6
5.00
4.60
4.20
4.00
3.80
3.60
3.40
3.20
3.00
2.80
2.60
100
60
20
VOLUME
1959
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
1970

GRAPH ILLUSTRATING RELATIONSHIP BETWEEN MONTH END QUOTED
MARKET PRICE OF POSEIDON N.L. (AN AUSTRALIAN COMPANY) AND MONTH END
QUOTED MARKET PRICE OF CONWEST EXPLORATION COMPANY LIMITED (OCTOBER 1969 - APRIL 1970)



CONWEST EXPLORATION COMPANY LIMITED

Appendix C-7

Comments on graph illustrating relationship between month end quoted market price of Poseidon N.L. (an Australian company) and month end quoted market price of Conwest Exploration Company Limited (October 1969 - April 1970)

On Page Two of the Conwest brief, reference is made to the dramatic short term fluctuations which can occur in the quoted market prices of some securities. The graph illustrates such a short term occurrence. Conwest purchased treasury shares of Poseidon N.L. (an Australian company) which were part of an issue for the purpose of raising exploration and development funds for that company. Subsequently, announcements by Poseidon of a "major discovery" resulted in a dramatic increase in the quoted market price of Poseidon shares. Over a period of several months the quoted market price has decreased dramatically from its former high level. The quoted market price of Conwest over this period has mirrored the dramatic increases and decreases in the quoted market price of Poseidon. If the proposed quinquennial revaluation had been in effect, the two major shareholders in Conwest whose birthdays occur in the period covered could have been faced with an accrued capital gain of $4,124,000 and a tax thereon of $1,031,000. This accrued capital gain would have been in addition to the accrued capital gain and taxes that would have been payable on revaluation number three as indicated in the schedule outlining the results of our study on the differential impact of quinquennial revaluation on the controlling shareholders of Conwest. However, as indicated in the graph, this accrued gain would have been fictitious as the quoted market price of Conwest has declined dramatically over the last two months covered. This is just a further illustration of the absurd results which could result from the revaluation proposal.

APPENDIX "H"

NAME: CONWEST EXPLORATION COMPANY LIMITED

SUBJECT: The Impact of the White Paper Proposals on the Canadian Mining Industry

Analysis of Appendix "G" by Senior Advisor

This Brief has been filed by Conwest Exploration Company Limited.

Conwest Exploration Company Limited was incorporated in 1938 to consolidate the ownership of several mining properties in Western Canada and Alaska, owned or controlled by Mr. Frederick M. Connell, O.B.E. and his brother W. Harold Connell, and to carry on exploration in Western Canada and Alaska. Subsequently in 1944, the company was provided with additional finances and expanded its operations to become the principal exploration vehicle. The company is still controlled by the Connell family.

The introductory comments contained in the brief state:

(1) We oppose the idea that wholesale revision of the Income Tax Act is desirable. We believe that where changes in the Act are warranted, they can be accomplished by amending the existing act from time to time, thus retaining the maximum of statutory and case law with which taxpayers are familiar.

(2) We are skeptical that equity in any tax structure is achievable. To isolate the Income Tax Act to achieve equity compounds the difficulty.

(3) We submit that with respect to the mining industry the incentives now built into the Income Tax Act achieves in part neutrality against the bias inherent in the industry by reason of the extraordinary risks patent in its nature and the absence of incentives elsewhere in the tax structure which are provided to other industry.

(4) We submit that capital gains tax is inappropriate in Canada at this stage in the country's economic development. Particularly inappropriate is the proposal to tax certain unrealized profits every five years. If capital gains tax is deemed necessary we recommend that the rate should be half the rate applicable to income and not in excess of 15%.

(5) We believe that the proposal to expose prospectors' gains to tax will result in hardship to the prospector out of all proportion to the revenue that will be derived.

The brief then deals with the following specific proposals contained in the White Paper:

(A) The Capital Gains Tax. (Pages 3 to 6)

(B) Prospectors. (Pages 6 to 8)

(C) Incentives to Mining Industry. (Pages 8 to 12)

(D) Integration of Taxes. (Page 12)

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: CONWEST EXPLORATION COMPANY LIMITED

Date Brief Received:

Principal Subject: The Capital Gains Tax

Present Tax Law	**Tax Reform Proposals**	**Principal Points of Brief**
See Appendix B, page 8.29 of February 11, 1970		Pages 3 to 6 of Brief This portion of the brief recommends: (1) No unrealized gains should be subject to tax. (2) The present distinction between capital gains and income receipts should be retained and realized capital gains be subject to a separate capital gains tax. (3) Capital gains should be taxed at rates not exceeding more than 50% of the rates applicable to income and the maximum rate should not exceed 15%. (4) In general, fair market value at valuation day should be the base for capital gains purposes. However, the taxpayer should have the option to elect to value his holdings either at the aggregate of their fair market value or the aggregate of their original cost. (5) If capital gains are to be included in income, then the maximum marginal personal rates should immediately be reduced to 50%. In the alternative, it could be provided that gains realized during the gradual reduction period would not be taxed at a rate higher than 50%. Moreover, the more meaningful averaging provisions recommended in the Carter Report should be introduced.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(6) If capital gains are to be included in income, then the personal rates should be restructured so that the maximum rate would be reached at a much higher level. The Carter recommendation was that the top rate of 50% be achieved at the $100,000 taxable income level.
		(7) Provision should be made in the integration proposals to place shareholders receiving capital gains through a corporation on the same basis as if they had realized such gains directly. The White Paper does contain such a proposal with respect to shareholders of mutual funds but this concept should be expanded to cover shareholders of other corporations.
		(8) More generous roll-over provisions should be introduced. Where, for instance, a taxpayer exchanges property and the form of his investment changes though its nature does not, a tax-free roll-over should be allowed. This should be the case even if the taxpayer's relative economic interest in the property may be changed as a result of the transfer or exchange.
		(9) Gains on sale of the principal residence of a taxpayer should not be taxed provided the "gain" is rolled over against the purchase of another residence. Further, a substantial once in a lifetime exemption on the gain on sale of the principal residence should be provided.
		(10) Items of personal property acquired for personal use or enjoyment should be exempted entirely from capital gains tax.
		(11) If capital gains are to be subjected to tax in whole or in part, existing estate taxes should either be abolished entirely or modified substantially.

Name: CONWEST EXPLORATION COMPANY LIMITED

Date Brief Received:

Principal Subject: Prospectors

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83, subsections (1) to (4) of the Income Tax Act This section exempts from tax the income of a prospector derived from (i) the sale of mining properties discovered by him, and (ii) the sale of shares received as consideration for the sale of such properties.	5.45 For many years the act has continued a provision which specifically exempts from tax the proceeds received by a prospector or a grubstaker on the sale of a mining property. This provision was intended to make it clear that the government viewed this type of gain as a capital gain which under the existing system would of course be tax-exempt. Under the new proposals capital gains are to be taxed and this exemption would therefore be repealed.	Page 6 to 8 of Brief This portion of the brief recommends: (1) The prospectors' and grubstakers' exemption should be retained. (2) If, however, the exemption is to be repealed, the prospector or grubstaker should be protected by a tax-free roll-over on the transfer of mining properties with no tax being exigible until such time as cash is realized through the sale of the vendor's shares. In addition, the more generous block averaging provisions recommended in the Carter Report should be introduced.

Name: CONWEST EXPLORATION COMPANY LIMITED

Date Brief Received:

Principal Subject: The Three-Year Tax-Free Period

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 83, subsection 5 of Income Tax Act This section exempts from tax the income derived from a mine for a period of three years after it commences production in commercial quantities.	1.51 Two main changes are proposed. The first would replace the three-year tax exemption for new mines with a special rule permitting capital costs of fixed assets purchased for the development and operation of a new mine to be charged off against income from that mine as quickly as desired. This change would take effect in 1974 at the expiration of the period for which the government in 1967 gave assurances that the three-year exemption would continue. The new rule would ensure that in the high-risk business of mining, taxes would not be paid until investments in new projects are recovered, but it would do so on a more economical basis than the present exemption.	Pages 8 to 11 of Brief This portion of the brief recommends: We recognize that there have been circumstances where because the mine has proven unusually profitable the amount of tax exempt income has been exceptional. We suggest that this situation, which we believe is responsible for most of the criticism of this incentive, would be corrected by limiting the tax exempt income to three years or recovery of invested capital whichever occurred sooner, at the same time retaining the right to capital cost and other deductions from taxable income provided in the present regulations.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.	

Name: CONWEST EXPLORATION COMPANY LIMITED

Date Brief Received:

Principal Subject: Depletion Allowance

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Part XII, Section 1201 of the Income Tax Regulations This section grants a depletion allowance of 33-1/3% of net mineral profits.	1.52 The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Every $3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to $1 of depletion allowances if and when his production profits permit. Depletion allowances on new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system.	Pages 11 and 12 of Brief This portion of the brief recommends: So long as mining taxes and royalties are levied against mining companies by the provinces and the federal government in their respective jurisdictions, we can see no practical alternative to percentage depletion to maintain equity for the industry. We, therefore, can only recommend the retention of the percentage depletion allowance at the present rates.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose	

Name:

Date Brief Received:

Principal Subject:

Present Tax Law

Tax Reform Proposals

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

Principal Points of Brief

Name: CONWEST EXPLORATION COMPANY LIMITED

Date Brief Received:

Principal Subject: Integration, or Grossing-up of Canadian Dividends

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
See Special Study No. 4 of March 4, 1970		Page 12 of Brief This portion of the brief recommends: "... either that a flat rate credit on dividends be retained or that some mechanism should be provided to ensure that where corporate income is not taxed as a result of incentive provisions the benefits of the incentive provisions not be 'recapturable' in the hands of the shareholder."

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

SPECIAL SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 21

WEDNESDAY, MAY 6th, 1970

Fifteenth Proceedings on the Government White Paper, entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 21 : 5)

APPENDICES:

"A"—Joint brief from Algoma Steel Corporation, Limited; Dominion Foundries and Steel, Limited and The Steel Company of Canada, Limited.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from the Steel Company of Canada, Limited.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from Dominion Foundries and Steel, Limited.
"F"—Analysis of Appendix "E" by Senior Advisor.
"G"—Brief from Gulf Oil Canada Limited.
"H"—Analysis of Appendix "G" by Senior Advisor.

21889—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(29)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and–
The question being put on the motion, it was–
Resolved in the affirmative."

- - - - - - - - - - - - -

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and–
The question being put on the motion, it was–
Resolved in the affirmative."

- - - - - - - - - - - - -

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

21889–1½

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

Wednesday, May 6th, 1970.
(30)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Carter, Connolly (*Ottawa West*), Desruisseaux, Everett, Gélinas, Haig, Hays, Hollett, Isnor, Macnaughton, Molson, Phillips (*Rigaud*), Welch and Willis–(19).

Present, but not of the Committee: The Honourable Senators Laird, Smith and Urquhart–(3).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

The Steel Industry–Joint Presentation.

Mr. D. S. Holbrook, Chairman & President
(The Algoma Steel Corporation Ltd.,);
Mr. J. B. Barber, Vice-President–Finance
(The Algoma Steel Corporation Ltd.,);
Mr. F. J. Sherman, President & Chief Executive Officer
(Dominion Foundries & Steel Ltd.,);
Mr. J. G. Sheppard, Executive Vice-President–Financial
(Dominion Foundries & Steel Ltd.,);
Mr. H. M. Griffith, President & Chief Executive Officer
(The Steel Company of Canada Ltd.,);
Mr. N. J. Brown, Vice-President and Comptroller
(The Steel Company of Canada Ltd.,).

The Steel Company of Canada, Limited.

Mr. H. M. Griffith, President & Chief Executive Officer;
Mr. N. J. Brown, Vice-President & Comptroller;
Mr. R. E. Karr, Assistant Comptroller.

Dominion Foundries & Steel, Limited.

Mr. F. H. Sherman, President & Chief Executive Officer;
Mr. J. G. Sheppard, Executive Vice-President–Financial;
Mr. A. D. Laing, Asst. to Executive Vice-President–Financial.

At 12:40 p.m. the Committee adjourned.

AFTERNOON SITTING

At 2:15 p.m. the Committee *resumed.* 2:15 p.m. (31)

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Carter, Connolly (*Ottawa West*), Desruisseaux, Everett, Gélinas, Haig, Hays, Hollett, Molson, Welch and Willis–(16).

Present, but not of the Committee: The Honourable Senators Laird and Sparrow–(2).

In Attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Gulf Oil Canada Limited.

Mr. J. McAfee, President & Chief Executive Officer;
Mr. C. D. Shepard, Chairman of the Board;
Mr. D. S. Lyall, Vice President, Finance;
Mr. R. W. Cochrane, Treasurer and Director of Taxation.

Ordered:–That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A–Joint brief from Algoma Steel, Corporation, Limited; Dominion Foundries and Steel, Limited and The Steel Company of Canada, Limited.
B–Analysis of Appendix "A" by Senior Advisor.
C–Brief from the Steel Company of Canada, Limited.
D–Analysis of Appendix "C" by Senior Advisor.
E–Brief from Dominion Foundries and Steel, Limited.
F–Analysis of Appendix "E" by Senior Advisor.
G–Brief from Gulf Oil Canada Limited.
H–Analysis of Appendix "G" by Senior Advisor.

At 4:15 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, May 6, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have four submissions today. I hope we shall be able to get through three of them this morning. The order of presentation this morning will be that we will first call on the steel industry, which is a joint presentation, then The Steel Company of Canada Ltd., then Dominion Foundries & Steel Ltd. I think this is a better order because things will fall into place.

Mr. Griffith of Stelco will lead the discussion and make the first presentation. Mr. Griffith, will you present your panel and then make your presentation.

Mr. H. M. Griffith, President and Chief Executive Officer, The Steel Company of Canada Ltd.: Mr. Chairman, honourable senators, this is a joint three-company brief. I have with me Mr. Dave S. Holbrook, Chairman and President, and Mr. John B. Barber, the Vice-President (Finance), of The Algoma Steel Corporation Ltd; Mr. Frank H. Sherman, President and Chief Executive Officer, and Mr. John G. Sheppard, Executive Vice-President (Financial) of Dominion Foundries & Steel Ltd.; Mr. Norman J. Brown, Vice-President and Comptroller, and I represent The Steel Company of Canada Ltd. My name is Harold M. Griffith, and I am President and Chief Executive Officer of Stelco.

Mr. Chairman, we welcome and appreciate this opportunity to appear before this committee to discuss our submission on the federal White Paper on Tax Proposals. We hope that you have had a chance to read and study the brief. We are here to expand on any part of it on which you may have questions. We have confined our submission almost entirely to the proposals to change the mining incentives. However, we do refer briefly to the integration concept in relation to the mining incentives, and to the proposed review of capital cost allowances. Our emphasis on mining is not because we do not have opinions on other parts of the White Paper, but because this is the largest single proposed tax change as far as the three steel companies are concerned. Dofasco and Stelco have submitted individual company briefs covering other aspects of the White Paper, and we hope that we will be able to discuss those areas later.

As a start, perhaps I could review very briefly some of the key points made in our joint submission. The Canadian industry represented here is largely Canadian owned. It is completely integrated, from raw material resources,—iron ore, coal and limestone—to the finished steel products. To support its expanding steel production, it has opened up several new large-scale iron ore mines in Canada in the last 15 years. We are certain that this mineral development would not have taken place without the incentives provided by the Income Tax Act.

As far as the past is concerned, we believe that the incentives have worked, and worked well, and that through their contributions to the growth and strength of the steel industry they have contributed to the economic strength of the country as a whole. We are also certain that the incentives proposed in the White Paper would be ineffective in maintaining the progress that has been made in the past. They would make a repetition of Canadian iron ore development of recent years very doubtful and they would force the steel companies to look carefully at alternative sources of ore outside of Canada.

Iron ore mining is different from other mining. Iron ore deposits are known, and require relatively low exploration costs. However, the investment required for mining and processing facilities is very high and the value of iron ore pellets is low. There is no bonanza in iron ore mining. For the Canadian steel industry iron ore mining in Canada is an integral part of making iron and steel. Much of the strength of the Canadian industry lies in the supplies of comparatively low cost Canadian iron ore resulting from the present incentives.

We believe that the steel industry's performance within the last few years in relation to the goals of the Economic Council of Canada has been as good as that of any industry in the country. We also think that adopting the White Paper proposals regarding mining would seriously hamper that performance in the future. A reduction in incentives to the extent suggested would be unfortunate for the country generally—for its economic growth, for its effort to reduce regional disparities, for its balance of payments and for the competitive position of one of its key industries. All of these are set out in detail in our brief and my associates and I would welcome the chance to expand on any part of it that you may wish to discuss. Thank you.

Senator Laird: Mr. Chairman, you mentioned alternatives. What did you have in mind precisely?

Mr. Griffith: Alternative sources, such as ore located in other parts of the world.

Senator Laird: What parts of the world?

Mr. Griffith: It could come from the United States, South Africa, or as far away as Australia.

The Chairman: Have you given thought when making that statement to the additional costs involved with regard to transportation, et cetera?

Mr. Griffith: With today's large vessels plying the seven seas it is possible to move ore in cargoes up to 150,000 tons and with unit train movement it is quite possible that these ores could be landed and competitive with other ores in North America.

The Chairman: You mean it would be cheaper to do that or more economic than to try to operate under the White Paper in the manner in which you are now operating?

Mr. Griffith: Yes, we believe this is true. The White Paper is actually forcing us out of the business as far as our ability to find and develop ores in Canada.

The Chairman: Is that because, having regard to the nature or the occurrences of your ore body, you really have a resource. You do not have to go exploring and therefore you could not earn depletion; is that it?

Mr. Griffith: We would not necessarily earn depletion some place else, that is true.

The Chairman: I meant in Canada. Is that one of the problems the White Paper presents?

Mr. Griffith: Yes.

The Chairman: The nature of your resource is such that you cannot earn depletion as provided under the White Paper.

Mr. Griffith: That is correct.

The Chairman: Therefore your full earnings, subject to write-offs, would be subject to corporate tax.

Mr. Griffith: That is right.

Senator Phillips (Rigaud): Mr. Griffith, does the steel industry in Canada play a significant part in looking after the requirements for our defence?

Mr. Griffith: Very much more today than in previous years.

Senator Phillips (Rigaud): Would you regard that as one of the factors?

Mr. Griffith: At the present time. My associates can check me on this, but I would think that roughly 50 per cent of our ore is coming from Canada and I think that perhaps as far as Algoma is concerned most of it is.

Mr. N. J. Brown, Vice-President and Comptroller, the Steel Company of Canada Ltd: It would be a greater percentage than that.

Senator Phillips (Rigaud): We are dealing with a national industry closely related to the subject matter of the defence of our country.

Mr. Griffith: Yes.

Senator Phillips (Rigaud): May I ask you to develop a little further the subject matter you raised with respect to the significance of your exports on balance of payments. Have you any figures to help us?

Mr. Brown: We have it in tonnage. 1968 is a better year to look at. 1969 was distorted by the strikes. I think you will find that the export–imports were about in balance. We still have to import certain grades and quality and types of steel. I think they were largely balanced in 1968 and were of the order of one million tons, if I recall correctly.

Senator Phillips (Rigaud): Would the proposed amendments under the White Paper, as compared with the present incentives under the Income Tax Act, affect, in your opinion, the balance of payments, meaning thereby a curtailment of exports?

Mr. Brown: It would to this extent, if in our case we were to join with other companies in the United States to develop ore deposits, such as in Minnesota. Already the Erie Mining Company is one of the largest in Minnesota. We have an opportunity of investing in another corporation there.

If we were to bring ore from Minnesota rather than Canada it would obviously have an impact on the balance of payments, because we would be buying ore in the Unite States and secondly, to the extent that these changes would increase our costs, we would be less competitive and therefore might not be able to generate the volume of exports that we have been able to do under these present rules.

Senator Phillips (Rigaud): Could I get some indication as to the use of the steel industry's liquid resources in the study of technological developments and as to whether the present incentives are assisting our national industry in being independent of outside sources, from the point of view of know how and development.

Mr. Griffith: I would say this is true. The incentives today are assisting us materially in developing our natural resources here in Canada, especially as far as iron ore is concerned.

Senator Phillips (Rigaud): Have we any figures with respect to research and technological development in terms of the earmarking of cash-flow for that purpose as an industry at large?

Mr. Griffith: The amount of money spent on research and development, technologically speaking . . .

Mr. Brown: It is in the millions each year. The amount spent on research by the industry would be $8 million or $9 million a year.

The Chairman: Would you say that this would be solely for the purpose of improving the operation of the industry itself?

Mr. Brown: Yes, and new processes, new techology, the whole bit of research and development related to the industry and the products of the industry.

The Chairman: I was interested in the answer you gave to Senator Phillips, that is, if you were importing from the United States it would be more costly and therefore you would be less competitive. I understood Mr. Griffith to tell me that if the White Paper is implemented that you would devote your attention and would be inclined to devote it to alternative sources outside of Canada.

Mr. Brown: Perhaps I could clarify that. I was trying to say that under the present rules the net cost of ore coming from Canadian sources to steel companies is less than we can buy it for from the United States. If you change that balance and it becomes more economic to bring it in from the United States the cost of ore would be higher.

The Chairman: When you said it would cost more you did not mean that it would cost more than if you operated under the White Paper in Canada. Is that what you mean?

Mr. Brown: I think the effect of the incentives is to reduce the net cost of ore to Canadian steel producers.

The Chairman: That is, the present incentives.

Mr. Brown: Yes and the present incentives are designed or at least they operate to link the industry to the Canadian iron ore deposits and development. It is a combination of the two. The incentives to the mining industry result in our getting a lower cost of steel than if we were bringing the ore in from another source at the present time. If the incentives are removed you can see that it comes closer into balance and there may be alternatives that are equal or better.

Mr. J. G. Sheppard, Executive Vice-President Financial (Dominion Foundries and Steel Ltd.): May I expand on Senator Phillips' question? In our brief, sir, in Appendix A at page 4, we indicate that if we had been operating without these mines and without the tax incentives, as we had been doing in the early fifties, we estimate that the difference in the balance of payments in the industry would be something in the neighbourhood of $300 million.

Senator Macnaughton: May I ask one or all of the witnesses if they could develop the idea of what the industry is doing vis-à-vis research, what type of research? Are they up to par with competitors in other countries? Just what fields are you developing? To help you, you said you were spending about $9 million, more or less.

Mr. Griffith: In the beneficiation of these low grade ores we have a continual expenditure of money. The methods differ depending on whether it is hematite or magnetite. Ores, when they are found in the earth's surface, may be a combination of both. One can only be separated from the gangue material by a special means and the other, let us say, by magnetic separa-

tion. So we are all trying to find ways and means of better beneficiation or upgrading of these low grade ores. This is one aspect in the industry. Further than that, we have been taking iron ore in various forms, usually in pellet form, although we have also performed this experimenting with fraction sizes—that is small fractions, something in the order of quarter inch or one-eighth inch—and put these through what we call direct reduction. We have been working on this process for at least ten years, I would say, and by this method we hope to cut down on some of the terrific costs of smelting the ore to form iron.

I would not venture to say how much this particular phase has taken in the way of money but we spend a lot of money in this area. We have had other folks join us in this effort. We have the Republic Steel Company in the United States, the National Lead Company in the United States, and also Lurgi Company in Germany, who have certain knowledge, techniques and facilities that we do not have. This has been a continuing development process in this area.

The Chairman: Senator Macnaughton, I should tell you that you are talking to Mr. Griffith, and I see in the financial report of Stelco that in 1969 Mr. Griffith, President of the company, was awarded a medal for the advancement of research, by the American Society for Metal, in recognition of his services over many years. So you are talking to the right man.

Senator Macnaughton: I also had in mind whether the industry had, shall we say, a steel institute, such as the pulp and paper industry has for research, or whether this research is individually done by each company?

Mr. Griffith: All three companies here contribute to a sizeable research program that goes on through the American Iron and Steel Institute. Because of the small size of the industry in Canada, we could not afford to try to maintain an association of that nature so therefore we have joined up with the American Iron and Steel Institute and we also belong to the British Iron and Steel group for the same reason. So, we are aware of technological improvements, as they come along. We make contributions as we think fit. At the present time we are spending money on blast furnace techniques in France. This IRSID is another research group which is purely French in nature, but these people have been doing work for at least ten or fifteen years that I am aware of, on what is known as the low shaft type of blast furnace. They became interested in our work on direct reduction and as a result of that they are, this spring sometime, probably late in May or June I believe, running very comprehensive tests on direct reduced material that will be fed into an electric type of smelting furnace, that is an electric arc furnace for continuous steel making. Steel making at the present time is a batch type operation, making a heat of steel, recharging your furnace and then making another batch. But with this device the French are working on and in which we participate, it is a continuous manner of making steel.

I might say that unless we find ways and means of doing a job more efficiently and more cheaply, there is just no salvation for us. I feel that in the future our competition in other parts of the world—and by that I mean the Japanese and some of the other countries—it is very very difficult to compete with these people.

Senator Hollett: I wonder if you have yet discovered any means whereby there might be a possibility of re-opening the Belle Isle Mines in Newfoundland, the iron ore mines?

Mr. Griffith: The ore in that part of the world unfortunately is high in phosphorous content and this creates problems in steel making. You must remove the phosphorous, otherwise the steel is of no value.

Senator Hollett: And you have not yet discovered a way of doing it?

Mr. Griffith: Yes, there is a way of doing it, but it is expensive and you just cannot compete with other methods.

Senator Beaubien: Pricewise, how competitive are we with our American cousins?

Mr. Griffith: I would say we are quite competitive with them. As a matter of fact, I would say on most of our products our selling price is below that of the United States on similar commodities.

Senator Beaubien: Considering that our volume is much less, that is very commendable.

Mr. Griffith: I think that the Canadian steel industry has kept up with the world in its development and techniques, and the facilities are probably as modern as any steel company in the world, including the United States.

Senator Molson: Could I ask Mr. Griffith and his associates this question. In reading the brief, I do not quite see any concrete recommendation with regard to the treatment of the incentives. It does not seem to me that they are spelled out. Do you want those to be

left alone the way they are today, or do you want any change in the incentives for the mining industry? Are you satisfied with the way they are today?

Mr. Griffith: We are quite happy with the incentives the way they are today.

Senator Molson: You are not suggesting that they be changed in any way?

Mr. Griffith: If they were made more valuable, of course we would not object to that.

Senator Hays: Has the introduction of the White Paper had any tangible effect on your exploration operations? Have you stopped exploration or have you spent money in other countries in anticipation of the White Paper?

Mr. Griffith: We have done this, yes. We have held up programs that we know we must proceed with, because we have to have iron ore and we will have to make this move perhaps some time this year. But we have delayed doing anything in Canada. One of the mines is the Scully mine in Labrador with the pellet operation at Pointe Noire on the St. Lawrence. This facility could be increased in size to ten million tons annually. That would be at considerable cost, I might say. But because of the threat of the White Paper, we have held off. We have held that in abeyance for the time being to see where we are going.

Senator Hays: Are there any other companies among your group?

Mr. Griffith: Yes.

Senator Hays: Can you specify those?

Mr. Griffith: There is Dominion Foundries and Steel Limited.

Mr. F. Sherman, President and Chief Executive Officer, Dominion Foundries and Steel Limited: We are partners in that same mine.

Senator Hays: But are there any others?

Mr. Griffith: We are the only two Canadian companies. There are United States companies which are not involved in the same way we are. That is, they do not have the same tax incentives as we.

Senator Hays: Have you increased your funds in so far as exploration in other countries is concerned? You mentioned Australia and the United States.

Senator Beaubien: And South Africa.

Mr. Griffith: These programs are always being presented to us and we are spending money—not large sums, I might say, but we are always on the alert.

Senator Hays: I realize that, but has there been any significant change since the introduction of the White Paper?

Mr. Griffith: No. The whole matter, as I say, is more or less held in abeyance. There is one big development, but it is so far away that we are only nominally interested at this time. That is the Hammersley deposit in western Australia.

Senator Hays: You also mentioned that you were quite competitive with any country in the world, and the introduction of the White Paper would change this situation.

Mr. Griffith: I may have given you the wrong impression there. So far as the United States is concerned we are competitive, but when it comes to countries like Japan, Australia and South Africa, those countries can make steel and undersell us right now without any difficulty. They do that quite often when they are looking for export markets.

Senator Hollett: Why can they do that?

Mr. Griffith: Not because they have any techniques that we do not enjoy, but because they are sitting right on top of their iron ore and coal. They do not have to move it any distance at all. Moreover, their labour costs are substantially lower than ours.

Senator Phillips (Rigaud): Are there subsidy features involved as well in those countries?

Mr. Griffith: I cannot speak with any authority, senator.

Senator Carter: What percentage of the Canadian market is supplied by the Canadian industry?

Mr. Griffith: I would be guessing. I had better ask somebody else to answer that question.

Mr. Sheppard: It will take me a moment to look that information up. Would you care to ask another question in the meantime?

Senator Molson: Are there any American tariffs against you?

Mr. Griffith: Yes. There is a tariff against our operation, with the exception of the automotive agreement. That is a saw-off both ways.

Senator Beaubien: Even with the tariff you are still competitive with the United States. If you had any spare tonnage you could sell it there.

Mr. Griffith: That is right. We don't sell that much tonnage in the United States, but we do sell a fair amount. I would say in total our company exports something in the order of 8 per cent of our total output. But that is not necessarily to the United States. Part of that goes to the United States, part of it goes to South America, some goes to the Middle East, some to Germany and some to England.

The Chairman: What would be the industry's total of export?

Mr. Sheppard: May I refer honourable senators to Appendix C, Table 7. I believe a glance at that table will answer both the last question and the previous question by Senator Carter. I might say that 1968 is a better year than 1969 for reasons which you probably know.

The Chairman: Yes, we are aware of the problem.

Senator Carter: You supply the major part of the Canadian market. If your prices went up, to or from other countries, then you would be raising the cost of living substantially, would you not?

Mr. Brown: To the extent that we could get higher prices, we would.

Senator Beaubien: Coming into Canada, is there a Canadian tariff?

Mr. Griffith: Yes. There is a tariff, but I believe it is quite low. I cannot say what it is. Do we have the figure on the amount of tariff on imports into Canada, Mr. Sheppart?

Mr. Sheppard: In steel. They are outlined in Table 13 of the same booklet, pages 1 and 2. They show "most favoured nation", "British preferential", and "general".

The Chairman: Most of it would be "most favoured nation", wouldn't it?

Mr. Sheppard: Yes, sir.

The Chairman: What would the average be? You have "free" and various percentages. What would be the heavy items of imports?

Mr. Brown: It depends on the geographical location. On the west coast, imports would come in from Japan and Australia and we would have the penalty of the freight rate out there, which is quite substantial. I am not sure what the tariff is on that, but, whatever the tariff is, their costs are much below what we could meet in many cases. On the east coast there are reinforcing bars. These are common forms of bars that are frequently highly competitive. They will come in much below our cost, even despite the fact that there is a $5, $10 or $15 duty. In other words, the duty does not prevent the importation of these products. The companies in those other countries have excess capacity so that they fill out their production and they will price accordingly.

Senator Hays: In that context, Mr. Chairman, what is the real reason why steel is more expensive in Edmonton than it is in Vancouver, travelling from the east?

Mr. Brown: That is a function of the freight rates.

Senator Hays: Is that really right?

Mr. Brown: That is it.

Senator Hays: It is not the importation of foreign ore?

Mr. Brown: No, sir. It is largely a matter of freight rates.

Senator Hays: Do you believe there should be some sort of equalization to off-set that?

Mr. Brown: It is pretty hard to make a general reply to your question, sir. It could be helpful in some cases, but one would have to study the situation to be able to answer definitively.

Senator Hays: Do you think it is time we started studying it?

Mr. Brown: We are anxious to expand our operations in the west. We keep looking at Edmonton and our Edmonton plant, and we are looking for sources of raw material, and this is a good point, because one of the deterrents to expansion in the west is the high cost of scrap. When the cost of scrap goes beyond a certain point it is a deterrent. There is a limited supply of available scrap. Once you get beyond 100,000 or

200,000 tons the cost goes over $35 or $40, because it has to be imported from Minneapolis in the United States. So that is a strong curb on the steel industry in the west.

We are now looking for some metallic source of iron ore that could be produced by the process Mr. Griffith has mentioned. We could find deposits in the foothills of Alberta. We have looked at some, in fact, but the expenses are such that the costs are still out of the question.

Senator Hays: Even in the field of exploration?

Mr. Brown: It is not the exploration. It is the development of the site and the process. Perhaps the very low grade of ore available, may require changes in processing and there are tremendous risks involved in putting up a plant without first testing it. But if the proposals in the White Paper come into effect, then these already marginal operations will just simply be out of the question for the feeding of steel operations in Alberta and Saskatchewan.

Senator Macnaughton: How does the productivity output of the Canadian worker compare with his foreign competitor?

Mr. Griffith: Well, I would say you just cannot make a straight comparison for the simple reason that our order pattern position is not like the order patterns that are received, for example, in the United States. They will set a mill up for certain sizes and they can run for two or three days. We often change sizes three or four times in one day, and this is lost time. Now if you compare the output of the crew in the two mills, it would look as if the Canadians were not producing as well, but this really is not true. I think the productivity of the Canadian worker is equally as high if he has the production pattern to work with that his United States counterpart has, or a comparative person in some other part of the world.

Senator Hollett: Would the implementation of the proposals in the White Paper seriously affect the 22,000 employees of The Steel Company of Canada?

Mr. Griffith: I think it is bound to affect them sooner or later, but to what degree I could not say.

Mr. Brown: I think its most serious impact would be on the expansion of employment.

Senator Desruisseaux: What is the difference in the cost of producing steel here as compared with that in the United States? In other words, is there much variance or is it about the same?

Mr. Griffith: Well, I can think of some of the larger companies where they have very large furnaces, and their cost of production per ton on, say, pig iron is less than ours. The reason for that of course is that their source of coal is closer. We have to move our coal farther than they do. Their coal is just a few miles away whereas our closest coal at the moment is in western Pennsylvania and Kentucky. This year we will have to bring coal from British Columbia, 200,000 tons of it. This comes about because of the shortage of coal that has been created by our Japanese friends.

Senator Desruisseaux: And the implementation will not make it any better, of course.

The Chairman: Tell me, Mr. Griffith, what would be the total income of the industry from its operations, let us take the year 1968?

Mr. Brown: Are you talking about the net profit of the industry?

The Chairman: Yes.

Mr. Griffith: It would be at least $150 million, wouldn't it?

Mr. Sheppard: You are talking in terms of profit rather than sales?

The Chairman: Net profit of the industry. I see Stelco in its statement shows roughly $68 million, but I was wondering what the figure was for the total industry.

Senator Benidickson: In almost every case the shareholdings are held to the extent of 90 per cent by Canadians?

Mr. Griffith: 95 per cent by Canadians.

The Chairman: You say the total would be in excess of $150 million?

Mr. Brown: The three companies might be $130 million or so, but the industry would be about $150 million. It depends on how you define the industry.

The Chairman: Well, I was letting you do that. You are here purporting to represent the industry. What would be the total amount of income tax paid in 1968 by the industry?

Mr. Sheppard: I can tell you for our company; we paid $29 million last year.

The Chairman: And what would the others have paid?

Mr. Griffith: Well, for our company, it would be . . .

The Chairman: I see it here. For your company it would be about $46.5 million. And what about the other members of the industry?

Mr. Brown: I think we might want to make a correction here. Mr. Barber has some figures where there are some offsets that would reduce the figures for the other two.

Mr. J. B. Barber, Vice-President–Finance, the Algoma Steel Corporation Ltd.: The best way to look at it is at the pre-tax earnings which in 1968 were $173.6 million.

The Chairman: Pre-tax earnings of the industry?

Mr. Barber: Of the industry. That is the three companies.

The Chairman: Then, what would be the sum total of income taxes paid by the industry?

Mr. Barber: There again, I do not think you can look at the taxes paid, you have to look at the taxes accrued including deferred taxes.

The Chairman: I was overlooking deferred taxes for the moment.

Mr. Barber: That is the tax for the industry for the year?

The Chairman: Yes, but I wanted to separate them.

Mr. Barber: Well, in that particular year, the taxes were $52.8 million and the deferred was approximately $5 million so there was a net of $47.5 million.

The Chairman: Actually paid?

Mr. Barber: No, that is the net of the two. Actually paid was $52.8 million.

The Chairman: Then would you care to project a figure, assuming that the provisions of the White Paper are in force? What would the increase be?

Mr. Barber: That is pretty difficult to say. I don't know if I could even make an estimate.

The Chairman: Well, with your depletion, what is the effective rate of tax at the present time?

Mr. Barber: The effective rate at the present time is actually somewhat higher than it has been. In 1968 it was only 27.4 per cent. But that was an unusual year with four mining exemptions. There were four new projets. There were four large iron ore mines.

The Chairman: Tax holidays?

Mr. Griffith: Yes.

The Chairman: Then in your operations, you are still in the position to earn tax holidays?

Mr. Barber: We are on one mine.

The Chairman: Then what would be the depletion element or what would it contribute in the reduction of, say, the 50 per cent corporate rate to an effective rate of 27.4 per cent?

Mr. Barber: I do not have separate figures for the years, unfortunately, as between exemption and depletion for the industry. Those are not available.

The Chairman: From the way we have been looking at it, it becomes rather important to get some appreciation of what is the effect of the depletion in the reduction of the effective rate of taxation, or what it may be. Is it possible to get such a figure?

Mr. Barber: We have stated in our brief, return on investment would reduce about 50 per cent on the White Paper proposal. That reduction would be made up of about 50 per cent each for exemption and depletion.

Senator Benidickson: In as much as the new mine status in these matters is being eliminated, you have to consider, comparing the present situation and the White Paper proposal, the poorer position you would be in profitwise if the White Paper proposals were implemented.

Mr. Barber: That is right.

The Chairman: You make that statement in your brief at page 7?

Mr. Barber: Yes.

The Chairman: That is that the difference as between the situation now and if the White Paper were in force might be to cut your average rate of return on investment by almost half.

Mr. Barber: Yes, that is right.

Mr. Brown: This is on investment in the iron ore mine.

The Chairman: Senator Everett. Are we now on the right brief?

Senator Everett: We are now on the right brief, Mr. Chairman.

Mr. Griffith, dealing with certain sections of your brief, at page 5 you say:

> For steel companies, exploration outlays represent a relatively small part of the total investment in mining. There is in fact a good deal of ore owned or leased and ready to be developed if the economics justify doing so.

Then again on page 8:

> Because this is an expansion of an existing mine rather than a new mine, the effect of the White Paper would be slightly less severe although it would still mean a substantial decline in the rate of return.

Again, on page 14:

> The relating of incentives to new mines, to the exclusion of expansion or extension of existing projects.

In referring to your own brief, which I have done previously—that is the Stelco brief, section 4.5, which deals with the same subject—and following on from Senator Hays' point, I gather you are concerned that the provision of the White Paper may lead to what I believe they call in the mining industry "high grading," and that there will be no incentive to develop marginal properties. Could you tell me what provisions of the present tax act relating to mining companies make it advantageous for a mining company to develop a marginal property, taking into account the fact you say in both briefs you would like to retain the present incentives?

Mr. Brown: Could I answer that?

Mr. Griffith: Go ahead.

Mr. Brown: In the first place, as you know, under the present rules the first three years of operation are tax free. Then, if the ore is consumed in Canada there is a depletion allowance based on the value of the prime metal, which in the steel industry's case is pig iron. This results in a reduction of the tax and makes a lower effective tax rate. So there are those two elements in making marginal properties economically feasible. If they are removed, it could have a drastic effect and eliminate marginal properties.

Senator Everett: Let us take the situation you referred to in your brief, in reference to two of the companies regarding the expansion of the Wabush operations. Presumably, those companies have had the three-year tax holiday, so that is no longer an incentive to them. Admittedly, depletion is a reduction in their income, but I do not see what incentive there is to those companies, under the present legislation, to develop those marginal operations.

Mr. Brown: In the case of the Wabush operation?

Senator Everett: Well, you are referring to it, so I am using that as an example. I could use the Pipe and Soab operations of International Nickel or the rim around the top of Sudbury.

Mr. Brown: In the case of the Wabush expansion Mr. Griffith referred to, it would take the present production of 6 million tons annually to 9 million or 10 million, depending on who participates and to what extent. It is true that for that additional three or four million tons of production we would not have the benefit of the tax-free period—it is over. It is the same mine and you cannot get it again. But the depletion allowance continues indefinitely and we continue to have that depletion allowance, which is important and significant. Whereas under the White Paper proposal, after 1975, after the five-year transitional period, that depletion allowance is eliminated. Even though it is an incremental proposition, if you look at the return on investment under the two situations, the present rules and the proposed rules, you will see a significant reduction in the return.

Senator Everett: That is a question we have dealt with, the overall tax rate, that is attributable to mining companies resulting in a return of the investment, but we are dealing with this specific question, that is the incentive. For example, we have had three or four resource extractive industries that have come before us and have said that the three-year tax holiday should be limited to the amount of the original exploration and development costs of the project—in effect, the return of capital; it should not go beyond that. We seem to be getting more and more concerned with the fact that the tax incentive on a new mine should have a certain limitation to it. You might have the three-year rule limited to the return of capital, you might have depletion limited to a certain return, and then you have another incentive, you use the same but very much increase the incentive to go out and find new mines or to develop marginal properties. What I do not

see is really where is the incentive in the present legislation for you to go out and mine marginal properties.

Mr. Brown: It is simply that the return on investment under present rules in a given situation is much higher than under the proposed rules.

Mr. Barber: If you regard the depletion as being an allowance in return for exhausting the ore body, the depletion itself is not an incentive, and in that sense you are correct; but if that is removed, then certainly an incentive is removed.

Senator Benidickson: An incentive for going ahead with a plan. Are you not different from some of the mining people that have come to us hitherto, when we talk about depletion? They would have to earn their depletion by looking for new properties, but your problem is quite different. You know where the ore is; you have already discovered an abundance of ore.

Mr. Barber: Precisely.

Senator Benidickson: But the question of whether or not you take another step and mine that ore depends in great part upon the incentive of the depletion allowance.

Mr. Barber: I can only take exception with one thing in that remark. That is that we have already discovered an abundance of material that could become ore provided the incentives to proceed were there.

Senator Macnaughton: You say that in the second paragraph on page 5 of your brief:

> There is in fact a good deal of ore owned or leased and ready to be developed if the economics justify doing so. The effects of the proposed changes on the steel industry would be to eliminate about three-quarters of the value of the incentives.

That is your position.

Mr. Barber: Yes.

The Chairman: Is it not part of the answer that the value of a depletion allowance as it exists now, which is a percentage of your net production income, will increase as you increase your production income?

Mr. Brown: From Canadian minerals.

The Chairman: That is right. However, the point Senator Everett was aiming at is one that we explored recently with Bethlehem Copper.

Having regard to the language in the White Paper, I wonder if you would comment on it? The White Paper admits that the mining industry requires special incentives, so we do not have to argue as to whether or not you should have incentives. That is why we are interested in knowing whether the so-called incentives under the White Paper are really incentives.

Paragraph 5.24 of the While Paper states:

> The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation.

Bethlehem Copper had reached a stage in eight years of operation where they had repaid their entire debt, which they had borrowed in order to bring the mine into production. They estimated that they had another 11 years of life. At that stage their ore was a resource, so they would not have any real exploration and development expense. Therefore under the White Paper they would not qualify for any earned depletion.

We were trying to rationalize as to whether there are not two categories. One, the category of a property which gets to that stage, where it has a profitable operation and is not in a position to make use of the proposed incentive. Secondly, the category that starts with what we may call moose pasture and the inducement to go into it and take the risks with the incentive rewards if you do get a profitable operation. Should you measure them differently?

I am trying to find a substitute for so-called depletion on the basis as it exists now or as it may under the White Paper. Would it give the industry what could truly be described as an incentive if the depletion continued at the present rate until 200 per cent of what had been laid out to bring the property into production was recovered?

This is on the successful operation. Could it be said at that figure that that particular company or operation is bearing its fair share of the tax burden?

Mr. Brown: It depends on the circumstances. Each case would stand on its own feet looking at the rate of return. If the change in the incentive does reduce the rate of return it could in some instances reduce it below the level that would be considered acceptable. It is very difficult to make a general statement.

The distinction is that we contend that iron ore mining is different from other types of mining. The value of the property is not as high; we are not likely to find a bonanza with a rich lode that will pay off in the first year.

The incentive seems to work in tying the development of the ore in Canada to the production of steel in Canada. We get more advantage than a company in the United States buying Canadian ore. The Canadian steel industry is a hook-up. The depletion allowance is a very strong incentive for Canadian producers of steel to develop and use Canadian iron ore.

The Chairman: That is due to the existing system. All I am inviting your comment on is should there be a limit at some stage in the availability of that depending on the success of the operations of the mine?

Mr. Brown: We do not think so.

The Chairman: I am not referring to earned depletion, but to a limit when it reaches, for instance, 200 per cent of everything you have laid out.

Mr. Brown: Are we discussing the exemption?

The Chairman: No, the depletion.

Senator Connolly (Ottawa West): Perhaps the gentlemen would like to think about that.

There is another aspect of the same problem. . .

The Chairman: Senator, you say perhaps they will think about it; there has been no response to that comment.

Is it possible that you could make some study of the question of an alternative?

Mr. Griffith: This is a part of our business. We pay taxes when we get to the end of the road on what we did. However, with respect to taxation on the production of iron ore, if we were in the business of selling iron ore it might be another matter, but this is a part of our bread and butter. We stand or fall on whether we do well and are competitive with other people in the world. We need all the breaks that we can possibly get.

It seems to me that the depletion allowance should go on as long as there is any iron left in that particular ore body. I do not know whether this explains the situation, but it certainly is a captive type of operation and it is a vital part of our doing business.

The Chairman: Are you saying that the depletion allowance should not be related to the cost of bringing the property into production?

Mr. Griffith: Yes, as far as depletion is concerned.

The Chairman: That it should take on the character of an absolute incentive? That is, if certain procedures are followed to bring the mine into production, as long as it operates it will be entitled to the depletion allowance on its net production income. You do not see any alternative?

Senator Beaubien: If the depreciation allowance is removed the cost of the steel increases.

The Chairman: I was not referring to removing it, but to a limit.

Senator Beaubien: After 200 per cent.

The Chairman: Yes. It is quite obvious that if you receive what we could refer to as a bonus, and that is suddenly cut off, you have not enough money to take care of your costs.

Senator Everett: The point you make is that depletion is related to the wasting asset and should go on for the life of the asset; that is very understandable. If that is the case, though, would it not be better to recommend gross depletion rather than net depletion?

Mr. Griffith: I do not know that I could answer specifically which would be the best approach. The manner in which it has been working has been quite satisfactory.

Senator Everett: That is for the steel companies, but I can think of other extractive industries that have not been able to take advantage of depletion by virtue of their exploration program. I think I am right in that.

Mr. Barber: I think one essential point is perhaps being missed. Because of the nature of integration in the iron ore and steel industry, and because of this incentive in depletion that has existed in one form or another for some few years, a large part of the total investment in the steel industry rests on the availability of iron ore, not just the investment in the mine. In other words, it leads to subsequent investment, which is dependent on continuing supplies.

Mr. Sheppard: It could well be that there is no uniform set of incentives for various extractive industries.

The Chairman: That is what I was leading to.

Mr. Sheppard: They work well. We are not suggesting we are experts in petroleum, nor are we suggesting we are experts in non-ferrous metals. We are suggesting that for the iron ore industry, as it relates to the steel

industry in Canada, these incentives have worked and worked well, and the White Paper incentives or any alternatives we have looked at just would not do the same job for the steel industry or for Canada.

Senator Everett: Do I understand, though, that the gross depletion would fulfill the same requirements, depending on the rate level?

The Chairman: The United States operate their allowances on a gross production income.

Mr. Barber: When you say gross, would you define that please? Gross of what?

Senator Everett: I could probably define "net" better. Net would be after operating costs and various exploration expenses.

Mr. Barber: Based on the value of the product? Is this what you are thinking of?

Senator Everett: The gross would be based on the gross value of the product.

Mr. Barber: The gross value of the product. Essentially that is what we have.

The Chairman: That is the present rule.

Mr. Barber: That is the present rule.

The Chairman: It is the net.

Mr. Barber: It is based on the profit.

Senator Everett: But after exploration and development expenses though.

Mr. Barber: Yes.

The Chairman: Honourable senators, it seems to me that we maybe should ask Mr. Gilmour to say something so that we can get this point developed in a nutshell.

Mr. Arthur W. Gilmour, Senior Adviser: Gentlemen, I would like to try to explain, in a nutshell if I can, exactly what we get today by way of incentive legislation for mines. There is nothing scientific at all about the incentives given today. When they are analyzed there is, with any ore body, be it iron ore or any of the other types of metals, the period of exploration and the development of the underground body. In that period, which may run for a few months to a couple of years or more, there is of course no income coming in; everything is outgoing and everything is capitalized.

When the mine comes into commercial production, under our present law there is a three-year tax holiday, and ordinarily, if it is a rich ore deposit it is worked like mad in order to get as large an amount of revenue as possible. In that three-year period no tax is paid. Ordinarily a tax would be paid of roughly 331/3 per cent if there were no exemption. Therefore, the rule of thumb works so that there is a saving of one-third of the income for three years. In other words, one year's income is left, and traditionally that one year's income seems to have been used to enable the mine to repay the high risk capital element that it had to raise to bring the mine into being. There is, in effect, one year's profits free of tax; that amount is retained.

The criticism that has been advanced to this very arbitrary three-year exemption has nothing to do with cost or anything else; it is just an arbitrary figure. The criticism to it has been that in some industries there have been these extraordinarily rich pockets of ore, and where someone is fortunate enough to have those, probably the three-year tax holiday is not needed to repay the risk capital; it is there. Because the three-year period works without any reference to cost, those lucky people who do not need the tax holiday get it anyhow. That seems to be the only valid criticism for certain phenomenally rich deposits. But there is the three-year tax holiday under our law.

After the three-year tax holiday is up exemption ceases, but there is deferred from year No. 1 during the pre-production period, and then during the tax holiday period, a saving of the exploration and development credits. There is also a saving of the capital cost allowances, and a saving of the underground work that has been carried out after production has commenced. Therefore ordinarily, or often, in the two-year period after the company becomes taxable there are enough credits so that probably in effect no tax is paid. Consequently, in this first period of, say, three and two years there is no entitlement to any depletion.

Therefore, in the normal mine there is a period of at least five years after coming into production before the depletion allowance starts to work. Then this depletion allowance is based on 33 1/3 per cent of the mineral profits; that is, the proceeds of the sales of the ore minus the normal mining costs, and then minus any exploration credits or the maximum capital cost allowance. In effect this 33 1/3 per cent means that the tax is reduced from roughly 50 per cent to 33 1/3 per cent, so there is a saving of 16 2/3 per cent of the tax, which works out to about one-sixth of the profits for all subsequent years.

Earlier we heard statements that the average life of a metal mine in Canada would run about 21 years. I do not know whether that is an accurate statement, but it has been made before this committee. You have to realize that our depletion allowances, as we are giving it today, bears no relationship to the cost of the mine. It is an arbitrary allowance that in effet lets you accumulate some cash for further exploration. It is arbitrary as all get-out, but the strange thing is that it seems to work. You get this one-sixth of your profits left to you really in cash and presumably you can use that to explore for new mineral deposits that you will need in the future. The criticism of the present depletion allowance is the same as the three year period. If you have a long-lived mine then of course your depletion allowance will go on forever, but if you have the normal mine your depletion allowance will go on for roughly 15 years and then everything peters out. Therefore, the depletion allowance we get under our present law is, in the most cases, not a very generous thing. It amounts to one-sixth of your mineral income. It only starts after about five years from when you come into production and of course if you had one of those extraordinarily rich and long-lived mines, and I believe there are very few of those in practice, then you get an unduly generous depletion allowance. For the ordinary mines it does not appear to be generous.

The point I wish to make is that our present depletion allowance runs on as long as you have profits. It bears no relationship whatsoever to the future exploration work you do, the cost of your mine or the life of your mine.

The White Paper proposal in a nutshell says that we will do away with the three-way exemption so we will take away the quick return of cash that ordinarily enables one to repay this capital or possibly to explore if that is the way one wants to act. Under our present law it would be foolish to explore in the name of the existing mining company, because those exploration and development expenses would operate to reduce the depletion allowance on the existing mine. Ordinarily, the exploration is done in the name of a subsidiary company so that a saving is made. The White Paper proposal says no to the three-year exemption and none of the 33 1/3 per cent depletion allowance. Instead, it says nothing will be given on the existing mines. It will cut off depletion and if one wishes to go out and explore either in the moose pasture or I guess it is moose pasture in all cases, then he will get a credit for his exploration expenses against his future income if he has any. He will get no credits against his existing mines and then the White Paper will give no depletion on the new mine. Instead, if three dollars is spent on exploration a credit of $4 will be given, that is, $3 plus $1. He will be told that if he is lucky and if he finds a new mine that there will be an exploration credit of $3 plus $1 that can be written off and having written that off against the profit of a new mine, fine, full tax will be paid on the profits from the new mine.

In the practical sense we have had a system that seems to work. As I say, it is arbitrary as the dickens, but it works and it has furnished existing mining companies with a source of cash. In theory this depletion represents a return of capital because it is a wasting asset. It is not computed that way, but it does give cash for future exploration. The White Paper proposal offers nothing unless out of your own money you explore and are lucky. A bonus of $1 can then be had for every $3 against the profits of the new successful mine.

I am sorry to take so long on this, but I do wish to emphasize the very substantial contrast between our two systems and also emphasize that our present system works. Admittedly, it is overly generous for those few extremely rich mines. I think the mining industry could successfully challenge that our present depletion is even generous and it has worked.

Senator Connolly (Ottawa West): There are some ore bodies that we have had described to us, which are very rich and which enable the operators to sell what they call direct shipping ores. Apparently, too, there are other ore bodies, such as this one, which in time run out of the super rich ores. What they have to do, as I understand the word, is beneficiate. When you take the decision to beneficiate you get certain tax concessions and certainly get capital cost allowance for whatever equipment or plant you need in order to do that operation. Is there any incentive other that depletion which might induce a mining company to use these low-grade ores for the purpose of continuing a high enough level of production?

Mr. D. S. Holbrook, chairman and president, The Algoma Steel Corporation Ltd.: I would like to speak to that one. After being exposed to several presentations before this body I have noticed the term high-grade has been mentioned. It should be understood that all the iron ore that is mined in Canada and used by the steel companies is low-grade ore. There is no such thing as a high-grade iron mine. The incidence of the mineral is very even through the entire thing. The only high-grade direct shipping iron ores today are found in Australia, and in Brazil there is a mountain of extremely high-grade ore that sells at the mine for less than $5 a ton as compared to $16 a ton in Canada. The average ores, as pointed out in the brief, are about 20 to 30 per cent and they are not fit for direct

smelting at all. So there is no question. This concept of having a rich ore body and taking advantage of it, does not exist at all in the iron mining business.

It is interesting to note that this three-year tax exemption was instituted in the 1930s and was brought forward by the Hon. T. A. Crerar. The whole mining industry was in the doldrums and it is that one particular feature that has been brought forward. At that time, the war interrupted it, but since that time the iron mining and all other mining in Canada has provided one of the great economic bases. There is no way to generalize and say that what is good for iron ore mining is equally good for nickel mining or copper mining or vice versa. Iron ore mining is an arm of the steel industry. There is no real commercial iron ore sold on the market today. It is all hooked up with the steel industry and must be considered as an integral part of it.

Senator Phillips (Rigaud): Do I understand you to say, Mr. Holbrook, that the iron ore industry is part of the steel industry because of the iron ore used being all low grade, and so on. Did you say you differentiate other mining companies from the point of view of its problems? Or did you say that you are merely an arm of the overall iron industry?

Mr. Holbrook: The iron mining is an arm of the steel industry.

Senator Phillips (Rigaud): But that observation does not apply to other companies that are not engaged in iron ore extraction?

Mr. Holbrook: I do not know that I interpret your question correctly.

Senator Phillips (Rigaud): If the iron ore extraction is merely a phase of the operation of the steel industry in Canada . . .

Mr. Holbrook: That is right.

Senator Phillips (Rigaud): With respect to other companies who extract from the earth metals other than iron ore, they do not have to go through the processes that you have to go through . . .

Mr. Hollbrook: No, there is a lot of commercial, non-ferrous mining . . .

Senator Phillips (Rigaud): That is it. I would like you gentlemen to understand the reason for this terrific probing on our part. There does not seem to be any quarrel with the necessity of providing incentives, generally speaking, but there seems to be a feeling that the so-called bonanza companies are not entitled to continuous relief, to the detriment of the economy at large. And what we are looking for is to see whether there is a basis for differentiation. At least, I am looking for that, but I cannot speak for my fellow senators, to see a reason for the justification that I would support for the maintenance of a freer holiday, shall we say, in the continuation of depletion allowance, provided we were to segregate certain types of operations which overall are not entitled to continuity, shall we say, in perpetuity. For myself, I have not come down to such a formula yet, and when you come before this body, and we are here as individual senators, we are anxious to segregate that type of operation, in order to meet the criticism which is directed against a by-product and is reflected in the White Paper. If we think we can come up with a solution, some time, dealing with the over pampered part of the industry at large, not related to iron ore and steel—recommendations, shall we say, from this committee and the committee in the other place—the maintenance of the present method of relief might have a better chance of acceptance.

The Chairman: Mr. Holbrook, there is iron ore produced in Canada which is pelletized and exported, sold in world markets; what you are speaking of is the section of the iron ore industry that is in co-operation with steel production?

Mr. Holbrook: The other section of the iron ore steel industry that pelletizes ore and shapes it, it is an operation owned by a portion of the American Steel Company.

The Chairman: I am thinking of Labrador Iron Ore people who were here. We had their brief. Earned depletion means nothing to them, because they have an ore area with a hundred years of life. This is another situation we have to look at.

The trend of the questions that I was asking was that unless you take a rule, like the present rule for tax holiday and depletion, and which may, in relation to some of the members of the industry sharing in it, be generous or overly generous, the alternative may be to break down the industry into different groupings. Could we get any help from you on that?

Mr. Holbrook: I could not offer any advice on that.

Senator Connolly (Ottawa West): This is a very important question, Mr. Chairman, on segregation. It may be that there should be a differentiation, first of all, between non-ferrous and the ferrous, and perhaps "ferrous" is too narrow a word, in any event, because

perhaps there should be a differentiation, for example, between nickel mining and copper, lead, zinc, iron. That deserves a special kind of tax treatment.

The Chairman: You may have a grouping that occurs to me. One group, for instance, suggests itself, but it may or may not apply to other operations in Canada—I do not know, at the moment—where the mining of the ore is part of the operation and obviously leads to the manufactured product. That might be one grouping. You may have a grouping that is straight production and export of the product. Then you have got some questions. How do you encourage people to go out and look for ore—because, at that stage, I suppose, in the looking process, we do not know what the average may be of success, but it may be one in 100, which might be a fair representation. How do you induce people at that stage to put up money, unless there is a carrott or whatever you call it, that if you do find something, there are incentives that are going to help them along the road.

These are different categories. But how do I prescribe treatment for these different categories?

Obviously, for the person who is taking a wild guess at what we call moose pasture he needs very good incentives in order to do it.

Then the person who uses the ore which he finds and mines as part of the operation of his industry, he falls into a different category. How do we set it up?

Mr. Sherman: Might I remark on that. Under the existing system, the exploration for these longshot mines, if you want to call it that, has gone on and has resulted in many successful mines coming in. Obviously, the people doing this are willing to take the gamble, because the returns, if they get a successful mine, are worth it. So I do not think that we need further incentives for these longshot explorations.

The Chairman: Then you say the existing law is good enough to get people to go into that phase of mining?

Mr. Sherman: Yes, it is.

The Chairman: What about the other category?

Mr. Sherman: In what respect?

The Chairman: Would you make two categories, one where you produce ore and you do not do any processing, you simply produce for export and sale. How would you suggest we might deal with incentives there?

Mr. Sherman: It does seem to us that the iron ore set-up, as it is related to the steel industry, is quite different from the other type of mines which are producing metallic products. I can see that there is a problem from the legislative side on how to split this up. At this point I would say that we know that the iron ore industry is different. I don't think that we have studied to see if there are other mining operations that are similar.

The Chairman: I was thinking, for instance, that British Columbia has a local rule requiring some percentage of production to be processed in British Columbia.

Senator Benidickson: If and when there is a smelter.

The Chairman: Ontario is making noises in that direction also, so I understand. Therefore, the category of the mining industry that is part of a large operation that produces an end product, a manufactured product, adds considerably more to the economy in the way of employment and income purchasing power and taxes. How should they be treated? Are you saying that you would be satisfied just to have a continuance of the present system of tax holiday and the present depletion?

Mr. Sherman: This has worked well for our industry, yes.

The Chairman: Do you think on that basis, using the language of the White Paper, that that type of industry is bearing its fair share of the burden of taxation?

Mr. Sherman: Yes, I do, because, as Mr. Holbrook said, you do not encounter the problem which the Government is obviously concerned about, that is, these bonanza operations, where you bring a mine into operation and it suddenly produces enormous amounts of dollars in the first few years. In an iron ore mine that just cannot happen. The iron ore mine just goes on at a steady rate from the time it starts to when it stops.

The Chairman: Well, is that precise? Bethlehem Copper told us that the property in the Highland Valley in which they are interested was 90 years in the making. Apparently almost every large company in the United States went in there and had a shot at it at one time or another. They decided after feasibility studies that the iron ore operation was not economic, but then the people who were here said that they still felt they could do domething about it and got some money together to do so, but they were only able to do something by getting the Japanese to come in and

finance the construction of a mill. But something startling must have happened when they started to expand underground, because they paid off all their debts in only eight years. So this is an uncertain element.

Mr. Sherman: I would think that was unusual, because normally your ore body is well proved out before you start to mine.

The Chairman: I could cite any number of cases, because I have been through a lot of them, where they run into jewellry stores, where their drilling did not disclose the jewellry store. I am thinking of gold mines, for instance.

Mr. Sherman: That is true, but I am referring specifically to iron ore where this just does not happen. In connection with your comment about these ore bodies having been known for many years, that is true also of iron ore bodies. One ore body that our company is in, in Temagami, had been known since 1870, but was not developed until the last few years.

The Chairman: Do I understand that you would possibly agree with the categories I have suggested for the mining industry and there may be more of them but that I am not going to get any further help from you on how we should treat the different groups, except that for you we should leave the law as it is?

Mr. Sherman: You won't get any help from us right at the moment, because this is a problem we have not thought about yet. We would be glad to take it under study, however.

The Chairman: Would you do some study on that, then? We are serious in our search. We think—or at least the Chairman thinks and some of the others have expressed views—that maybe there should be categories.

Senator Connolly (Ottawa West): Perhaps the umbrella should not cover them all.

The Chairman: Yes.

Senator Phillips (Rigaud): The question of the bonanza mines was the real problem I tried to develop before. I for one think you are entitled to the maintenance of the present relief, but I think such rights are endangered by excrescences or protuberances in other directions which cause criticism. We are groping for some solution—at least I am groping for some solution of that problem.

Mr. Chairman, may I refer the witnesses to page 4 of their brief, in which they refer to the fact that the proposals for integration of corporate and personal income taxes would seriously reduce the effectiveness of the present mining incentives. It is stated that, since the benefits of the incentives would not be passed on to shareholders through tax credits, the industry's capacity to raise outside capital would be considerably reduced in relation to business generally.

For puposes of the record, I should like to quote that last phrase:

> . . . the industry's capacity to raise outside capital would be considerably reduced in relation to business generally.

Is it, an expression of opinion or is it based upon contact with underwriting and financial houses, that the ability to raise capital would be affected if the White Paper were implemented in the form of legislation? Have you been in touch with underwriting houses? Have you interviewed financial people and bankers and determined from them that your industry would be affected if there was such an implementation, and that it would reduce your ability to get capital for underwriting to develop further expansion?

Mr. Barber: Our studies have shown that we would have a very severe reduction in our net production and cash flow as a result of the implementation of the White Paper.

Senator Phillips (Rigaud): Therefore you don't feel you need direct contact with underwriters and bankers in that respect.

Mr. Barber: That is right. We have talked with them, but not formally. It is only our own personal observations that we are relying on.

Senator Phillips (Rigaud): Do they support your statement?

Mr. Barber: They do, yes.

Senator Phillips (Rigaud): Do they in part justify your conclusions which I have just quoted?

Mr. Barber: Their comment is that the steel industry is unpopular enough now as an investment without further impairing it.

Senator Phillips (Rigaud): That is what I wanted to know.

The Chairman: Are we saying that the pattern of borrowing in connection with mining is a pattern that has grown up on the basis of there being available tax holidays and depletion allowances?

Mr. Barber: That is quite true.

The Chairman: And there would have to be a complete reassessment of what attraction there would be for financial people to provide money without those things being available.

Senator Connolly (Ottawa West): Mr. Chairman, they are relating that directly to the iron ore industry.

The Chairman: That is right.

Senator Connolly (Ottawa West): They are talking exclusively about the iron ore industry.

The Chairman: Quite right.

Senator Connolly (Ottawa West): Can the gentlemen tell us what percentage of their production is exported? Can they tell us, too, what percentage of the iron ore production in Canada is exported? And when I have received the answers to those two questions I should like to follow up with another question, if I may.

Mr. Brown: In 1968 the production of iron ore was 44 million tons. Of that the Canadian steel companies produced ten million tons. In 1968 in our case, as I recall, our export represented about 10 per cent of our sale value.

Senator Connolly (Ottawa West): So 10 per cent of the steel production in Canada is exported.

Mr. Brown: I cannot speak for the whole industry, but it would probably work out to about that.

Mr. Sheppard: Actually, for the industry in Canada it is a little more than that, but 10 per cent is not a bad figure for us either.

Senator Connolly (Ottawa West): Can you tell us what percentage of iron ore production is exported? Even a rough boxcar figure will do.

Mr. Sheppard: Yes, we can do that. Table 10–the exports were 80 per cent.

Senator Connolly (Ottawa West): 80 per cent of the iron ore produced in Canada is exported. Now, can you tell us this; what is the tax rate imposed under the present law on the iron ore industry and what is the tax rate which would be imposed if the White Paper proposals were implemented, including in each case the mining tax of the province, and again I want just an average figure. I do not want a precise figure because I know it varies from province to province.

Mr. Brown: When you are speaking of iron ore, the total iron ore, we do have this mixture of ore shipped out of the country unprocessed, in the form of pellets or concentrates. Then you have the ore that is processed in Canada and this will have to be taken into consideration to determine the incidence of tax. It is different because of the effect of the incentives on the further processing of ore in Canada by the steel industry.

Senator Connolly (Ottawa West): Let us talk about the ore that is shipped out in pellets or as raw ore.

The Chairman: Senator Connolly, when we get all these divisions, we get conflict and maybe confusion. I wonder if it might be possible to get perhaps two figures, which I have already asked for, one is the net profit or the income from all the operations that relate to iron ore mining in Canada, and then the sum total in dollars of all taxes that were attracted as a result of that operation, and the rate on that.

Mr. Sheppard: I think, Mr. Chairman, the answer to that question will be quite complex for a number of reasons. We have gone through, as Mr. Barber said earlier, a period when the rates have been rather low because of the exempt period for three different mines coming in very close together. The other thing that would not be brought out in this figure and that we think would be tremendously important is that we have provided, I think, with these mines a greater tax base in employment in the mines, in the secondary industries that support the mines and the construction industries that have built the mines. So I do not think you could say what are the taxes that have arisen from these in any simple formula.

Senator Connolly (Ottawa West): Perhaps I can help you by asking this question; in the event that the tax proposals in the White Paper are implemented, is the exported ore going to be more costly on the foreign markets? In other words, are the tax impositions in other places where ore is available, and you mentioned Australia and Brazil, and I take it that you could use ore from Australia or Brazil and if the ore from the Canadian source is more expensive, you would possibly consider turning to those other sources. Now what is going to be the relative position if the White Paper proposals are implemented?

Mr. Griffith: I would say it would tend to throw people out of work in the iron ore industry, because there would be less ore mined in Canada.

Senator Connolly (Ottawa West): You are saying Canadian ore would not be competitive on the foreign market?

Mr. Griffith: Quite right.

Senator Connolly (Ottawa West): By much?

Mr. Sheppard: Perhaps I can answer that question. I checked with Mr. Brown before because I may be giving out confidential information, but I do not know how else to answer your question. Our American partners in Wabush indicated to us the other day, and they have been in it since we have, that despite the incentives, they have not made a cent out of Wabush yet.

Senator Connolly (Ottawa West): And they are American?

Mr. Sheppard: They are American.

Senator Connolly (Ottawa West): And the American tax is lower than the Canadian tax.

Mr. Sheppard: I don't know the answer to that. It depends on the State. But as far as their investment in Wabush is concerned, and we have been talking about the possibility of expanding in Wabush, there is very great doubt as to whether they will go in, and they were looking at calculations based on the current incentives, and not on the proposals.

Senator Connolly (Ottawa West): And yet you know the resources are there?

Mr. Sheppard: We know that. And you can get it by increasing the capacity and reducing the costs. This is on an operation where there is a tremendous increase and a lot of the facilities are already in. Does that answer your question?

Senator Connolly (Ottawa West): It helps a bit. But you also mentioned the fact that the rate of return is an important factor in the developing of an ore body or a mine. Do you think that it is appropriate in a competitive industry of this kind for the tax laws to be stipulating how much the rate of return should be from a given industry?

Mr. Brown: I don't think it should be, but I think from the practical standpoint of determining whether the projects will be gone ahead with or not, the rate of return will be in the final analysis the determining factor.

Senator Connolly (Ottawa West): And the capacity to sell?

Mr. Brown: The capacity to sell. It all gets back to a return on investments. Now, in our case, taking the four mines that are in operation, the composite rate of return under the present rules is between 12 and 14 per cent. So it is not a bonanza. We went ahead with these large-scale investments on the basis of the present rules, and we have made projections taking into consideration the three-year tax holiday and the depletion allowances, and calculated DCF return. We came up with this 12 to 14 per cent. Now, applying the proposed rules to the same proposition from the beginning, that return drops to 6 to 7 per cent. It is halved. This is the return on investment after taxes, 6 to 7 per cent, after the application of these proposals. Now, with money at 9½ per cent or 10 per cent or 8 per cent, you can see that it is not too attractive.

Senator Phillips (Rigaud): I would call that a brutal message.

Mr. Brown: What is more important is that when we look ahead at the expenditures the industry has to make if it is going to continue to compete and grow, the hundreds of millions of dollars required, and if you look at the rate of return under the existing rules, and again under the proposed rules, you see a drastic difference. It is almost the same pattern. Then there is the impact on the industry. Looking at our own company to 1980, we have detailed projections. We have to plan that far ahead in order to know what we are going to do. The investments are so large and it takes so long to get into operation that we have to plan well ahead. We can see rates of return coming down to 5 or 6 per cent on the overall after the impact of these proposals.

This, in a nutshell, is why we are so hesitant about this thing. How can we go ahead on these large-scale ventures when the prospects of the late seventies are of earning rates of return in that order?

Senator Connolly (Ottawa West): In other words, you are not going to be competitive.

Mr. Brown: We cannot be. We just cannot undertake those investments, and we will have to look for some other avenues.

Mr. Sheppard: Mr. Chairman, may I supplement Mr. Brown's remarks by one thing?

The Chairman: Yes, Mr. Sheppard.

Mr. Sheppard: These figures he has quoted are based on being able to run these operations full out and on having a market for the product. There is no allowance for a catastrophe or washouts on railways or lack of markets; this is based on full operations of mines, and in the case of the one where we have 90 per cent ownership, our return on the White Paper basis would be about 6 per cent.

The Chairman: I was wondering if you could tell us what the geographic area was like, Mr. Griffith—its features, population, if any, etcetera—at the time when you went into these areas to develop these mines.

Mr. Griffith: Well, in Labrador there was nothing there. I was up there, and I think some of the other gentlemen here were too, when it was just a barren waste. It was typical northern Labrador muskeg and water and hills, with no population there of any kind—nothing. Of course, the Iron Ore Company of Canada were the first people to build a railroad north to Burnt Creek, and up in that area which is another hundred miles north, but that was very formidable countryside and it took a lot of money. I do not know exactly how much money we have invested in this area. Of course, we join on to the railroad at Mile 200 or thereabouts, with our railroad which goes over to Wabush and, of course, now there are two townsites there and I suppose there must be upwards of 6,000 people living in this area.

Senator Connolly (Ottawa West): In each one?

Mr. Griffith: No, in the two towns, in Labrador City and in Wabush.

The Chairman: What about secondary industries there?

Mr. Griffith: I do not think there is anything there but that.

The Chairman: Now?

Mr. Griffith: Not to my knowledge. There are just some minor service facilities, and most of those are down at Sept-Îles.

Senator Connolly (Ottawa West): Would Sept-Îles have been developed without this development in the north?

Mr. Griffith: No.

Senator Connolly (Ottawa West): How many towns have sprung up from this wilderness?

The Chairman: I think there are four or five, as a matter of fact, are there not?

Mr. Griffith: I would think so, because there is one at Gagnon, which is the U.S. Steel Corporation's operation; another one at Wabush; the Carroll Lake development which brought forth Labrador City; and then there is another town at the north terminus of this railroad of the Iron Ore Company which is up on the direct shipping ore area. Then, of course, there is the village of Sept Îles itself, with maybe a population of 500 or 600.

Mr. Sheppard: That is the Quebec-Labrador area alone, without the expansion in the Ontario north country.

Senator Connolly (Ottawa West): In other words, you have had development and expansion without a federal department of economic expansion and development to do it.

The Chairman: And by private capital, and some of that private capital is still outstanding.

Mr. Sheppard: Very definitely.

Senator Connolly (Ottawa West): Without the inducements this could not have happened? Are you firm on that?

Mr. Griffith: That is absolutely right. You could never have afforded to have gone in there without the incentives.

Senator Connolly (Ottawa West): Could we come back to the question, and I think perhaps this is where we came in: You still need these inducements?

Mr. Griffith: Yes, we still need them.

The Chairman: They still have not paid back the money they were able to raise under these inducements in order to do the job. That is a correct statement, is it not?

Mr. Griffith: Yes.

Senator Connolly (Ottawa West): They said they have not got anything out of the Wabush.

Mr. Sheppard: I said that our American associates have not taken a nickel, and our company certainly does not have our investment back.

TABLE 14

CANADA AND UNITED STATES (a) — COMPARISON OF BASE PRICES OF SELECTED STEEL PRODUCTS AS AT JANUARY 1954 — 1970 and MARCH, 1970

(Canadian Dollars per Hundred Pounds)

	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	March 1970
Structural Steel Shapes, Carbon																		
U.S.	$3.99	$4.19	$4.53	$4.79	$5.12	$5.27	$5.33	$5.57	$5.88	$5.93	$6.15	$6.14	$6.14	$6.31	$6.31	$6.67	$7.04	$7.42
Canada — Sault Ste. Marie	4.60	4.60	4.80	5.05	5.30	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.75	5.75	5.95	5.70	6.35	6.35
— Hamilton . . .	4.60	4.60	4.95	5.15	5.40	5.40	5.40	5.40	5.40	5.40	5.40	5.40	5.65	5.65	5.65	5.65	6.15	6.15
Steel Plate, Carbon																		
U.S.	3.99	4.17	4.43	4.65	4.97	5.08	5.14	5.37	5.67	5.72	5.99	5.98	5.98	5.98	6.18	6.56	6.93	7.31
Canada (b)	4.60	4.95	4.95	5.25	5.45	5.45	5.45	5.45	5.45	5.45	5.45	5.45	5.45	5.45	5.45	5.45	5.85	5.85
Hot Rolled Sheet, Carbon																		
U.S. (18 gauge and heavier)	3.82	4.09	4.26	4.49	4.79	4.89	4.95	5.17	5.45	5.50	5.72	5.71	5.71	5.88	5.88	6.33*	6.66*	6.97*
Canada (over .080)	4.25	4.25	4.30	4.60	5.00	5.00	5.00	4.95	4.95	4.95	4.95	5.15	5.15	5.15	5.35	5.35	5.70	5.70**
Cold Rolled Sheet																		
U.S	4.65	4.88	5.25	5.51	5.87	6.02	6.09	6.36	6.71	6.77	7.04	7.04	7.04	7.20	7.44	7.74	8.17	8.44
Canada	5.10	5.10	5.25(c)	6.05	6.35	6.35	6.35	6.35	6.35	6.35	6.35	6.35	6.60	6.60	6.80	6.80	7.20	7.20**
Merchant Bars, Carbon																		
U.S.	4.04	4.24	4.58	4.87	5.27	5.45	5.51	5.75	6.07	6.13	6.40	6.39	6.39	6.34	6.48	6.80	7.18	7.18
Canada — Sault Ste. Marie	4.60	4.60	4.80	5.05	5.30	5.30	5.30	5.30	5.30	5.30	5.30	5.30	5.65	5.65	5.65	5.55	6.20	6.20
— Hamilton . . .	4.60	4.60	4.95	5.15	5.40	5.40	5.40	5.40	5.40	5.40	5.40	5.40	5.65	5.65	5.65	5.55	6.20	6.20

(a) U.S. prices are Pittsburgh base prices.
(b) Up to 1959 Hamilton only; from 1959 on Sault Ste. Marie supplied sheared mill steel plate at identical mill base price as Hamilton.
(c) In July 1956 price increased to $5.75.

* Cdn. 60¢/100 lbs. deducted as representing average size extra included in U.S. base.
** These prices are for Hamilton. Algoma's are lower by 15¢/100 lbs. since February 10th, 1967.

U.S. prices for plate and structurals do not include an increase of 35¢ U.S. per hundred pounds that is expected to take place on March 1, 1970.

Note: U.S. prices have been converted to Canadian funds at yearly average spot rates.

Sources: Iron Age and The Algoma Steel Corporation, Limited.

The Chairman: Gentlemen, is there anything else we have missed or that you have missed in putting forward your brief, that we should now turn to?

Mr. Griffith: A question was asked when we were going through, I think, Table 14, in Appendix "C", which shows some of the base prices of selected steel products. You will notice that in every case the Canadian price is considerably below the U.S. price.

Senator Molson: Mr. Chairman, I am wondering if it would not be a good idea to file that table right in the present proceedings, the first middle and last periods shown here.

The Chairman: Why not incorporate in Mr. Griffith's evidence Table 14 specifically? Is there any objection to that?

Senator Molson: No, I think that should be done, because it is a very interesting table relating to prices.

The Chairman: Is there anything else you would like to add, Mr. Griffith?

Mr. Griffith: No.

The Chairman: Is there anything any of the members of your panel would like to add?

Mr. Griffith: No, Mr. Chairman.

The Chairman: That brings us to the consideration of the two specific briefs. The first is The Steel Company of Canada, and that means that you, Mr. Griffith, Mr. Brown and Mr. Karr will remain, and Mr. Sherman will disappear for a short time.

Honourable senators, we are now going to deal with the brief of The Steel Company of Canada Limited.

Mr. Griffith, have you a statement? We do not have to introduce the panel again. You already know Mr. Griffith, Mr. Brown and Mr. Karr.

Mr. H. M. Griffith, President and Chief Executive Officer, The Steel Company of Canada Ltd.: Mr. Chairman, as I stated my name earlier, you now know who I am.

We welcome and appreciate the opportunity of appearing before this committee to discuss the Government's Tax Reform proposals. Our submission deals largely with those parts of the White Paper other than the mining incentives. This is because the mining changes were discussed in detail in our joint brief with Algoma and Dofasco and, while we only touch briefly on this subject on pages 4 and 5, we wish to emphasize that the mining proposals are of major importance to us.

Mr. Norman J. Brown, of course, is Vice-President and Comptroller of our company, Mr. R. E. Karr is Assistant Comptroller, and these gentlemen will be glad to discuss any questions you may have to ask.

In Section II of our brief we describe what we consider to be the essential basis for a sound tax system in Canada. You will notice that we emphasize a growth-oriented fiscal policy and the importance of co-ordinating the federal tax system with those of other levels of government in Canada and of countries with which we have close commercial relationships.

Section III discusses the philosophy of the White Paper as we see it, and points out the general areas where we disagree with the proposals.

In section IV, we comment more specifically on some of the proposals. As I said earlier, our views on mining are summarized on pages 4 and 5.

On pages 6 - 8, we discuss integration of the corporate and personal income taxes. Aside from questioning the validity of the concept, we point out a number of areas where we think the proposal is deficient. In particular, we are concerned about its effects on the raising of capital, especially where corporate tax has been reduced by incentives.

We have serious reservations about the capital gains tax in the form proposed, and our comments here are on pages 8 – 11.

Our views on the single corporate tax rate, on the international taxation proposals, and on pension plans are found on pages 11 – 14. For each of these, we have made suggestions to lessen what we think are deficiencies in the proposals.

Following this, we have some brief remarks regarding income averaging and entertainment expenses. While we have not dealt at length with capital cost allowances on page 15, we consider this to be a most important subject, and we will have more to say when the government is ready to discuss it.

Finally, our general conclusions are set on pages 15 and 16.

Perhaps the best way to sum up our views is to quote the concluding sentence.

> We believe that in attempting to reform the nation's tax structure, the federal Government should carefully and thoroughly weigh the economic consequences of their proposals,

recognizing the necessity for full co-operation with the provinces in the development of a sound and consistent system of taxation at all levels of government.

Mr. Chairman, we hope that these hearings will help to accomplish this. As I said earlier, my associates are available to answer your questions.

The Chairman: I notice, Mr. Griffith, that your comments on specific proposals in relation to mining briefly summarize what was developed in the course of the hearing of the mining industry.

Mr. Griffith: That is right.

The Chairman: You have stated very succinctly, in other words, that you have got where you have by reason of these incentives being available to you.

Mr. Griffith: Quite right.

The Chairman: And if you are going to push on from there you still need them; is that a fair summary?

Mr. Griffith: Yes.

Senator Connolly (Ottawa West): Mr. Chairman, you mean the brief of the Steel Industry which we just heard

The Chairman: That is right. We would like to hear in a summary way your view on integration. What is it that you criticize and suggest, if anything, to deal with this situation?

Mr. N. J. Brown, Vice-President and Comptroller, The Steel Company of Canada Limited: One of the results of integration, of course, would be that any incentives that reduced the rate of tax to the company would have an effect on the amount of creditable tax for shareholders.

There are other complications in the integration system as proposed which we, in looking at the administrative problems, think detract from its suggested or proposed advantages.

The Chairman: How would you compare the White Paper proposal of a creditable tax with a varying percentage by way of depletion now enjoyed by the shareholder?

In other words, if the shareholder receives a dividend of $100 from a mining company, he may pay income tax only on the dividend less 15 per cent, 20 per cent or 25 per cent. What are the advantages and disadvantages as against the White Paper proposals?

Mr. Brown: It would depend first on the income tax bracket of the shareholder. In the case of a shareholder paying a 50 per cent rate and receiving the 20 per cent tax credit, and in the last couple of years there has been a shareholder's depletion allowance in addition, he might be better off than the shareholder who is in the lower bracket.

The Chairman: The White Paper proposed to substitute a creditable tax for the 20 per cent deduction from tax and for the percentage of depletion allowance that he is entitled to deduct from the dividend before he calls it income.

Mr. Brown: That is right.

The Chairman: Would you say that from his point of view the shareholder is obviously better off under the existing system?

Mr. Brown: It depends on which shareholder we are referring to. If the effective tax rate is also reduced by incentives, the benefit of that reduction does not flow through to the shareholder, compared with a company whose tax rate is higher.

Creditable tax, of course, would be higher in the case of a company whose effective tax rate is 50 per cent than one at 35 per cent or 40 per cent. In that event the benefit of the incentives would not flow through to the shareholder. In turn, that would have an influence, as was brought out earlier, on the attractiveness of the shares.

The Chairman: That would have the effect of exposing the shareholder to more tax.

Mr. Brown: That is right.

The Chairman: No matter what his bracket was.

Mr. Brown: That is right.

Senator Phillips (Rigaud): Mr. Brown, the view has been expressed that the integration plan would involve pressure on companies to distribute dividends in excess of what should or would be done in the normal course of events, which would result in inflationary effects.

Mr. Brown: The answer to the first question is yes. Others are better qualified than I to answer with respect to inflationary effects.

Definitely there would be extreme pressure brought to bear in determining dividend policy when thinking of the shareholders, which we must do.

In order to grow, earnings must be retained. There would be circumstances where the business decisions would be strongly influenced by shareholder pressure to get as much distributed as fast as possible in order to take advantage of the creditable tax.

Senator Phillips (Rigaud): Therefore, the officers and directors of companies would be subjected to the dilemma on the one hand of shareholder pressure, and on the other hand of conservative policy protecting resources for need and expansion in dry days?

Mr. Brown: Correct.

The Chairman: What about the shelf provision in that? I call it the shelf provision, where you must pay out profits or surplus in two and a half years. Would you comment on that?

Mr. R. E. Karr, Assistant Comptroller, The Steel Company of Canada Ltd.: I think that just accentuates the situation, the fact that first of all you are under pressure to distribute funds that you would not under normal business practice distribute in order to get the benefit of the integration, and at the same time are up against the limitation of two and a half years. This really just increases the problem.

The Chairman: The suggestion for meeting that point of view, in the White Paper is that you make a rights issue. Would you comment of that?

Mr. Brown: That is a stock dividend.

The Chairman: Yes, a stock dividend.

Mr. Brown: It does not accomplish very much, because it is just providing the same amount with more shares. I do not see that that solves the problem.

Senator Phillips (Rigaud): I would say the benefit would be for the lawyers, would not you think?

Mr. Brown: Yes, indeed.

Senator Phillips (Rigaud): With the work involved.

Mr. Brown: And the computer people and all the equipment required.

Senator Phillips (Rigaud): Lawyers and printers.

Mr. Brown: Printers, computers and accountants.

The Chairman: And the government revenues from incorporation fees.

Mr. Brown: Yes. It is extremely complicated. I have the feeling that it is oversimplified in the White Paper. It is almost impossible to visualize all the ramifications, but it is quite formidable when you begin to think of what could arise and how you set up for it. We have seen this in the White Paper, and I read in the paper the other day that we should be gearing up for providing for these credit taxes. It is a formidable operation. Its consequences are difficult to determine.

The Chairman: Have you any estimate of the amount of cost that might be involved, or increased staff in order to provide the information you would be expected to provide to shareholders in the make-up of their creditable tax?

Mr. Brown: I could not venture a suggestion. All I know is that it will cost more.

The Chairman: And will need more bodies.

Mr. Brown: Oh yes.

Senator Molson: Could I ask Mr. Brown if in his opinion the tax returns of individuals in Canada will be very much more difficult to make because of what he has seen of the White Paper requirements?

Mr. Brown: Oh, undoubtedly.

Senator Molson: Do you think it might be a good thing to join the accountants profession?

Mr. Brown: Yes, it would, from that point of view.

Mr. Karr: I doubt very much if there are sufficient chartered accountants in the country to handle it.

Senator Molson: Do you think every taxpayer would need his own chartered accountant?

Mr. Brown: And his own lawyer.

Senator Molson: We take the lawyers for granted round here; we accept that.

Senator Phillips (Rigaud): If they were their own lawyers it would be helpful because there would be more work the next year. Let me put this question to you, Mr. Brown, referring to page 6 of the brief, paragraph 4.8 subparagraph (a) dealing with the distinction between widely held and closely held companies. This has been the subject of considerable discussion in this committee between representatives of the taxpayers and members of the committee. Some members of the committee see the value of the distinction, but I notice that you do not see the value of the distinction. Is that because you simply cannot see any logic to it, or do you go deeper into it?

Mr. Brown: It does not seem logical when you think of two large companies in exactly the same position competing with one another but being treated differently for tax purposes.

The Chairman: Like Simpsons and Eatons?

Mr. Brown: Yes, and General Motors and maybe Ford Motors of Canada; I do not know.

Senator Everett: How are the companies treated differently for tax purposes when we are referring to widely held and closely held corporations?

Mr. Brown: The proposals in respect of the creditable tax and capital gains and the capital gain revaluation are different.

Senator Everett: I am dealing not with the shareholders but with the companies themselves; that is, the corporate entity. Is there any difference between the closely held corporate entity and the widely held corporate entity under the White Paper?

Mr. Brown: I am not sure whether I am qualified to speak on that subject. I would defer to Mr. Karr, who perhaps can answer that. We are more familiar with the widely held corporation concept. Here we are expressing a point of view because of the logic of the proposal, or lack of logic.

The Chairman: The 50 per cent corporate rate would be the same.

Senator Everett: You make the case, I believe, that under the White Paper there would be some advantage accruing to a closely held corporation that is not available to a widely held corporation. When dealing with a corporate entity I cannot see any difference in the tax treatment between the closely held corporation and the widely held corporation. I can see a difference between the shareholders of those two entities but not between the corporations themselves.

Mr. Brown: And the impact of the tax.

Senator Everett: Oh yes. You are quite right that the shareholders are treated quite differently.

Mr. Brown: That is right.

Senator Everett: But corporations compete at the corporate level, not at the shareholder level.

Senator Beaubien: It depends on whether they are raising money.

Mr. Brown: We are dealing here with a tax system. Does it seem proper that there should be a distinction? If in fact there is no difference, why should there be a distinction? You say the effect of the tax is the same. Then why make the distinction in the first place?

Senator Everett: I think there is a distinction at the shareholder level.

The Chairman: Honourable senators, there are distinctions too—and I was going to ask Mr. Gilmour to deal with it—where a closely held company holds shares of a widely held company and where a widely held company holds shares of another widely held company and also holds shares of a closely held corporation.

Senator Beaubien: Perhaps Mr. Gilmour could tell us about this.

The Chairman: Different results follow. Would you develop that, Mr. Gilmour?

Mr. Gilmour: The widely held-closely held concept is really basic to the proposals of capital gains and not to corporation tax itself. As you know, on our capital gains proposals, instead of following the established world wide concepts, which are to divide short term and long term gains, we say that we will tax all gains other than the gains made by shareholders of widely held corporations at 100 per cent, which would fall into income, whereas with a gain on a widely held share only 50 per cent falls into income.

There is considerable doubt whether the basis we are adopting for experiment is valid. Ordinarily corporations will each pay the same 50 to 52 per cent of tax. With a widely held corporation that is a shareholder of another widely held corporation, when dividend flows through there is a special tax of $33^1/_3$ per cent levied upon the receiving widely held corporation. Wheareas, when there is a closely-held corporation that is receiving a dividend from a widely-held corporation then 50 per cent of the tax paid flows through to the closely-held corporation.

Senator Beaubien: Tax free?

Mr. Gilmour: In effect, yes, because if the dividend paying company has paid a tax of 50 per cent then you get credit for that tax to the extent of half the tax. There normally is a free flow-through.

To answer Senator Everett's specific question, there can be a dividend with respect to the proposed capital gains tax payable by the corporations and there can be a tax on dividends received. Taxes on the ordinary earnings of a corporation from the industrial or commercial operation should be at the same rate. It is only if we are faced with this rather peculiar capital gains proposal that is put before us that there will be any difference.

Senator Connolly (Ottawa West): I am sorry, I did not hear that.

Mr. Gilmour: If the capital gains proposals that are laid out in the White Paper come in, then there will be a difference in the annual taxes payable on certain capital gains and certain dividends, but only on those two items.

Senator Connolly (Ottawa West): It is a complication. In addition to the inequity, it is a complication in the administration and in the preparation of the return.

Mr. Gilmour: It is going to be a dreadful complication to compute this integrated dividend credit. Under our present non-scientific methods it just grew like Topsy, and it is a very simple operation. The White Paper proposals on integration are going to complicate things desperately. I do not think we have enough chartered accountants to furnish one per person. Anyone who has looked at the papers issued by the Department of Finance as to how you will compute dividend credits—well, I had better take a couple of months off to study.

Senator Molson: We would have to form taxpayers' clubs to engage their own accountants.

Senator Phillips (Rigaud): It seems we have disposed of the last subject-matter. I would now like to direct Mr. Griffith and his colleagues to page 10 of the brief which deals with your decisions with respect to the subject-matter of capital gains. This is shown at paragraph 4.14. I think, on account of the importance of your company, Mr. Griffith, I would request that the chairman ask you to be good enough to read that recommendation into the record.

Mr. Griffith: It reads as follows:

> If a capital gains tax is to be introduced in Canada at this time, we believe:
>
> (a) It should be patterned after the United States capital gains tax.
>
> (b) A flat rate tax of no more than 25% should be imposed. To lessen the initial impact, such a rate should be approached gradually over a period of years.
>
> (c) No distinction should be made between widely-held and closely-held corporate shares.
>
> (d) A distinction, similar to that in the United States between assets held for more and less than six months, should be made.
>
> (e) Provision should be made for "roll-over" on disposal of a principal residence.
>
> (f) A much higher minimum value than that proposed in the White Paper should be established for personal proprerty subject to capital gains taxation.

Senator Phillips (Rigaud): With the approval of the chairman, would you be good enough to supplement these conditions with respect to the subject-matter of the deemed-to-be sales which were dealt with earlier in the paper? What are your views with respect to the application of a capital gains tax on so-called capital assets?

The Chairman: That is in paragraph 4.13.

Senator Phillips (Rigaud): Would you read that please?

Mr. Griffith: Would you like me to read that?

The Chairman: Yes.

Mr. Griffith: Paragraph 4.13 reads as follows:

> The feature of the capital gains proposal which most directly affects Stelco is that concerning the quinquennial revaluation of shares of widely-held corporations. We view this proposal with some anxiety for the following reasons:
>
> (a) It would impose a tax on income before it was realized, or which might never be realized. We consider such a concept unacceptable within a framework of "income" tax legislation.
>
> (b) It would discriminate between owners of shares of widely-held Canadian corporations and holders of other forms of investment. In many cases, it could require liquidation of the investment to pay the tax.
>
> (c) It would have an adverse effect on the terms on which widely-held corporations could raise equity capital by making investment in foreign equities relatively more attractive. This would be a result opposite to that presumably considered desirable under the integration proposal.

The Chairman: Mr. Griffith, there is one item here in (c) of 4.13. You say that the five-year revaluation would have an adverse effect on the terms on which widely-held corporations could raise equity capital by making investments and foreign equities relatively more attractive. Would you develop that, please?

Mr. Karr: The reference is to the situation faced by a shareholder of, say, Stelco, a widely-held corporation, as he approaches the five-year revaluation point. For that particular individual the revaluation will have an influence on his decision to hold or dispose of his shares. With a continual revaluation among all shareholders throughout the country it seems to us that the natural result of this will be a depression in the value of the shares.

We do not have this kind of situation with the foreign equity where the shareholder can retain ownership of it without fear of the capital gains tax, at least until he has got the money in his pocket.

The Chairman: The other thing I wanted to refer to was paragraph (f) of 4.14. You say:

> (f) A much higher minimum value than that proposed in the White Paper should be established for personal property subject to capital gains taxation.

I have received, as Chairman of this committee, a letter from Ward-Price Limited, an old established firm, which goes back to 1914. They carry on the business of making evaluations for estates. They conduct regular auctions, selling all types of pictures, furniture, silverware, et cetera.

Senator Connolly (Ottawa West): Where are they located?

The Chairman: In Toronto. I would like to read from this letter. I think you will find parts of it very interesting.

> When the proposals were first made—

That is, on this question of valuation on personal items—

> When the proposals were first made a representative of the Finance Department called on our Mr. Browne to ascertain our reactions to the valuation angle of the proposals, our name apparently having been given to him for contact. There was some discussion regarding the matter and our Mr. Browne advised that the proposal to assess personal items over $500 (five hundred dollars) in value was completely impractical and almost impossible, since there were not sufficient qualified valuators in Canada to undertake this work and do it to a deadline. Also the figure of $500 suggested is completely unrealistic since practically every household in the $5,000 per year income bracket, or better, has several items of over $500 value, such as a dining suite, a bedroom suite, a chesterfield suite, a coloured television, etc. Whilst a valuation of real assets of the magnitude as envisaged by the White Paper would certainly be of financial benefit to firms such as ours nevertheless it would appear to be unwieldy and perhaps unfair. If a price of $5,000 (five thousand dollars) were set then there might be some justification in that this would take into account such luxuries as fine silver, rare oil paintings, and exceptionally fine pieces of antique furniture in which there should be appreciation over the years, whereas there will only be depreciation on such things as dining suites, bedroom suites, chesterfield suites and coloured television sets. It should also be pointed out that if capital gains are to be taxed on household assets and antiquities that such capital gains should only be assessed when the goods are sold as prices fluctuate very greatly from year to year and an instance of this is the Barbizon School of Paintings. A few years ago pictures by the artists of this school such as Weiss, Jacque, Dupres and others were selling very much below value whereas recently they have greatly accelerated in price but this condition may not maintain and they may once again fall out of favour. It would, therefore, be completely unrealistic to assess a value this year and five years from now have to make an allowance for depreciation or appreciation, neither of which would be factual unless the item had been sold. It should also be taken into consideration that if personal assets are to be appraised and assessed for appreciation then an undercover or black market will be created in that many people who wish to sell a valuable item will locate a buyer, make a private transaction that will never be recorded and whilst this may be against the law as is it even at the present time, since Ontario retail sales tax must be paid, nevertheless it is going on and will be encouraged by reason of the "White Paper".
>
> With regard to the suggestion of full taxation of small businesses.

This is another item, which I will not deal with at the moment, but we may come back to it again.

Here is a firm operating in this field, it is called on both by the estate tax people in Ottawa and by the provincial authorities, under succession duties, to make valuations. So they have a standing, and they are in this business. They are experienced in all these areas. They say that to fix a value of $500 is completely impracticable. I thought this would be a good time to bring this up.

Senator Connolly (Ottawa West): It is an excellent piece of evidence, Mr. Chairman.

The Chairman: Yes, this is from a man who knows what he is talking about.

What is the next item that you would like to deal with, Mr. Griffith?

Mr. Griffith: Are there any questions which senators might wish to ask?

The Chairman: I was wondering about your item "International Taxation".

Senator Molson: While we are on the question of small corporations and large corporations, I think we

might ask this witness what their view would be on a suggestion which came up in a previous meeting that, instead of the elimination of the tax benefit to the small corporation on being carried up to the large corporation—your suggestion, Mr. Chairman, would follow through—that there be some definition of a "small corporation", that that definition should be established, and that that corporation simply would be assessed at the lower rate, because it was defined as a "small corporation". I think that was your suggestion.

The Chairman: This is really under the Small Businesses Act.

Mr. Brown: I do not think we would be opposed to that. The lower rate of tax, on the first $35,000, does not mean that much to us. As we said here, our feeling was that we depend on small businesses becoming larger businesses. We have seen this over the years. We would not like to see the law framed in such a way it discouraged the development of small businesses.

Senator Connolly (Ottawa West): Have you seen that on a pretty broad scale?

Mr. Brown: The development?

Senator Connolly (Ottawa West): Yes?

Mr. Brown: Yes, particularly in the last ten to fifteen years.

Senator Connolly (Ottawa West): In spill-over industries?

Mr. Brown: I do not know whether they are spill-over industries or not. They are the kind of industry which perhaps takes part of our product and builds it into some product in a simple way and they grow rapidly. We have seen many examples of that, amongst customers of ours. The more successful of them would be now out of the small business category but they started off in a small way as a small enterprise of an individual, and it is this kind of enterprise and initiative of an individual that we do not want to see killed.

Senator Connolly (Ottawa West): It is the same way in the product of the bigger customers, as they go on.

Mr. Brown: We want to encourage them and not discourage them.

The Chairman: Their problem, Mr. Brown, is credit.

Mr. Brown: That is right.

The Chairman: And they have to find it usually within their own retained earnings.

Mr. Brown: They also expect the manufacturers to help them out. We do as much as we can, but there is a limit there, too.

Senator Desruisseaux: On page 12, in item 4.18, international taxation, I think this is quite important and pertinent, to deal with certain aspects of taxation. Do you mind reading this into the record?

Mr. Griffith: Very good, senator. It reads:

> International Taxation: Stelco supports any effort to prevent the use of foreign "tax havens" to *artificially* reduce the amount of Canadian taxes payable. However, many Canadian businesses conduct *bona fide* international operations, in the course of which their foreign income may be taxed at less than the prevailing Canadian rate. These are not situations in which improper advantage is being taken of the tax law. Rather, the Canadian business is being taxed in the same way as its foreign competitor. An attempt, therefore, to collect additional Canadian taxes on foreign income where Canadian tax rates may be higher than those of the foreign country could impair the competitive position of Canadian business. Extreme care must be used to distinguish between the *bona fide* and the artificial business transaction.

Senator Desruisseaux: Have you any further comment on that?

Mr. Brown: A number of problems arise here. As I understand the proposal, first of all it is going to depend on the tax treaties between the countries. If we do not have a tax treaty, that will make it adverse for Canadian companies having operations in foreign countries. But looking at the countries with which we have tax treaties, the question is whether we should pay a higher rate of tax than a domestic company in that country doing the same kind of business. It does not have to be on a competitive basis within that country. Our interpretation of this is that there would be cases where that would not apply, where the Canadian company doing business through a foreign subsidiary in a foreign country might be paying a higher rate of tax than its competing industry in that country.

Mr. Karr: If I might expand on that point to bring it closer to home, Mr. Chairman, Stelco, as you heard earlier, is interested in developing export markets. It has a European sales organization represented by a subsidiary company. With this sales organization Stelco's Canadian manufactured products are sold in various countries in Europe. Under the present law, Canadian Tax revenues are completely protected. The sales transfer price of those products going out of the country is at an arm's length price. There is no question of any reduction in Canadian taxes. If the European subsidiary happens to be in a low tax rate country and is competing in that area with other

domestic corporations paying the same rate ot tax, this does not remove the *bona fide* nature of the operation. However, to bring the earnings home, because we do not have tax treaties with all countries a second subsidiary must be used to avoid overexposure to foreign withholding taxes. As we understand the White Paper, this would then create passive income whith could be subject to tax in Canada. In effect, this would wipe out our competitive position. It would be double taxation.

To us this is a completely bonafide situation. The White Paper is not very clear but it appears that in a situation like that there would be additional Canadian taxes levied on income which, from our standpoint, is not earned in Canada at all.

Senator Desruisseaux: What percentage of total income would be coming out of Canada?

Mr. Karr: We are talking of an extra 15 per cent withholding tax.

Senator Connolly (Ottawa West): What percentage of income is what he asked you.

Mr. Karr: In our case it is quite nominal.

Mr. Brown: You mean related to total income?

Mr. Karr: Yes, related to the total.

Senator Connolly (Ottawa West): Would it be as much as 10 per cent?

Mr. Karr: No, it would be much less. This is because the normal Canadian income on these transactions is allocated to Canada.

Senator Connolly (Ottawa West): But the effect would be to press upon the development of industry within Canada, and the expansion of industry.

Mr. Karr: It would deter the expansion of exports.

Senator Connolly (Ottawa West): It is going to depend, then, on the earned wealth in Canada.

Mr. Brown: To that extent, yes.

Mr. Griffith: That is right, yes.

The Chairman: Mr. Brown, I notice you deal with income averaging in paragraph 4.23, and you recommend a continuance of the present Section 36. We have had some evidence here on instalment payment contracts, chiefly in the lower field of income, where people may pay $15 a month over a period of 15 years and then the increment of course all comes out in the 15th year. Now, whatever was the result of that under Section 36, there was an averaging which the person was entitled to. In other words, you would apply the average of this rate in the last three years to the extra in the year in which he received this money.

Mr. Brown: Yes.

The Chairman: The White Paper proposal would take away that benefit, because it says that the increment must amount to at least one-third of the income that you ordinarily earn in that year, or earn qualified to average, and this would appear to have its greatest adverse effect on the people in the lower income groups. I think that is in effect what you say in your paragraph 4.23.

Mr. Karr: Our objection to the income averaging merely is that it appears to be very largely ineffective. If our mathematics are correct, for a person who is earning approximately $18,000 a year, the additional increment will be taxed at his full marginal rate. There will be no benefit through averaging. We have not really looked at the low income people particularly, Mr. Chairman, but my recollection of the whole thing is that while the low income people may benefit from averaging they only benefit in a very limited amount—certainly in relation to the presently existing rules.

The Chairman: We are inviting comment, because we have had this sort of argument from quite a number of people who have specialized in instalment payment contracts for people in low income brackets, and it has been indicated to us that what would likely happen is that such people, rather than being exposed to the burst of income in one year, where they would have to pay a high rate of tax, would rather close out their instalment payment contracts before the application of the White Paper, which, of course, would be an adverse effect on the company's operations and would also shut off a source of incremental income for the individual.

I notice another item in paragraph 4.25, where you talk about entertainment and related expenses. Are you satisfied with the provisions in the Income Tax Act at the present time relating to a reasonable amount of money being laid out for the purpose of earning income?

Mr. Brown: Yes. We think that that is proper and legitimate and we think it could be left as it is under the existing rules.

Mr. Karr: We have a great deal of respect for the staff of the Department of National Revenue.

Senator Connolly (Ottawa West): Mr. Chairman, I should like to ask the witnesses if in their own experience in the use of the regulations in the tax requirements, which I take it affects them just as it affects any other taxpayer in business, they are at times called upon to justify and give expenditures laid out for this purpose? And do they find that sometimes their expenses are allowed and sometimes are not allowed?

Mr. Brown: I am not sure about the disallowance of them, because I don't recall any of them being disallowed. But periodically the tax assessor will ask for expense vouchers, particularly for the senior people of the company, and will add them up for the year and will ask questions of either myself or Mr. Karr about certain items. On such occasions it is then up to us to substantiate these expenses as being for the purpose of earning the income of the company.

As I have said, we have not had any cases of disallowance. That is not because, although the amounts were too large, they skipped them; but it is because we have been able to justify the expenses, regardless of amount. The point I am making, really, is that they have checked them.

Senator Connolly (Ottawa West): This I think is the point we want to raise and nail down here as tightly as we can.

Senator Everett: Mr. Griffith, I will refer you to the statement on page 2, item 2.2. The second sentence there reads:

> Moreover, because of the openness of the Canadian economy, the Canadian tax system cannot be significantly different from the tax systems of competing economies. That is, Canadians should not be put at a competitive disadvantage through the operation of the Canadian tax laws.

I want to discuss that with you for a moment to see how in your mind we can make up the difference in the need for tax revenues as between the United States and Canada. In that regard, I refer you to the statement that you make on page 6, item 4.7, and the last sentence which I would ask you to read.

Mr. Griffith:

> The objective of most corporations is to earn enough after-tax income to give shareholders a reasonable return on their investment. We are of the opinion, therefore, that general price levels reflect a major portion of the corporation tax paid.

Senator Everett: Could you also read, Mr. Griffith, on page 16, item 5.2.

Mr. Griffith: The entire item?

Senator Everett: If you would, sir.

Mr. Griffith:

> We also believe that changes in a tax structure are reflected sooner or later in price levels, wage and salary levels, and investment returns. The effect of changes made today in the name of equity, therefore, can be lost tomorrow as there relationships throughout the economy shift to reflect them.

Senator Everett: The general meaning of those two statements to me, and I wonder whether you agree, is that the taxes that are imposed on a corporation, one way or another, are eventually passed on to the price of its products. Do you agree with that statement?

Mr. Griffith: Not in total, of course, but a company—any company is in business to make money, and if the tax situation affects the things that we have to buy, then naturally that pushes our costs up. This, I think, has to show through ultimately.

Senator Everett: It affects the price levels.

Mr. Griffith: It pyramids the costs, or at least it tends to.

Senator Everett: That would mean, wouldn't it, that if you impose those taxes and affect the price levels, and you impose them generally on corporations, the effect on the price levels would be non-discriminatory in the sense that it would affect all goods that are bought.

The Chairman: Domestically?

Senator Everett: Domestically. I am talking purely domestically. Would you agree with that?

Mr. Brown: Generally, yes.

Senator Everett: On the other hand, would you not agree that a sales tax that is imposed in one form or another can discriminate so that certain items are not affected by the tax. For example, you could exclude clothing or food or other items from the operation of the tax if you are dealing with a sales tax rather than a general corporations tax. Do you agree?

Mr. Griffith: That is right. The impact would either be direct or it would not be there. I mean where the sales tax is concerned.

Senator Everett: So it could discriminate?

The Chairman: Senator Everett, I would think a sales tax in its ultimate results has a greater impact on the price that the purchaser at the end of the road will have to pay than the problem of income tax which you are discussing.

Senator Everett: That may be your view, but it is not germane to the subject, because the subject is whether or not the sales tax discriminates. We have discovered in various investigations that have been made by the Senate that because of the per capita efficiency, if you want to call it that, of Canadians as against Americans, Canadians will have to bear a higher incidence of tax than Americans if they want the same standard of living, or if they want the standard of living that is arrived at today. And in fact, as my colleague points out, they do this now. They

bear a higher incidence of per capita tax than the Americans do.

Mr. Brown: Well, if we are not as an economy as productive as another economy and at the same time we want more social benefits, then obviously we have to pay a higher price, because we cannot produce as much and we are expecting more.

Senator Everett: That is right.

Mr. Brown: And that is a load on the economy.

Senator Everett: So we are going to end up paying a higher tax. In fact we have ended up in that position. But you make the very valid point on page 2 that in order to promote growth in Canada, that corporation taxes and personal taxes should not be any more rigourous than those imposed in the United States. Now, does all that indicate to you that part of the answer to the tax problem in Canada is to impose a tax structure on persons and individuals, that is to say on various forms of income, one that is very similar to that of the United States or at least does not impose a greater impost than in the United States, and that the difference that is required be made up by sales or value-added taxes that can be discriminatory—that is discriminatory to the benefit to the lower-income person by not imposing a tax on the goods that he generally buys and by imposing a sales or value-added tax on the luxury goods? Would you agree that that would by a better answer than the White Paper?

Senator Beaubien: Mr. Chairman, I might point out that we have a federal sales tax at 12 per cent already, and the Americans do not have one.

Mr. Griffith: Let me compare the two economies, 200 million people as compared to something over 20 million. It is rather difficult to see how you can have the same situation in two such completely different economies. Certainly the more social benefits that are handed out, the more difficult the problem becomes.

Senator Hays: Well, what social benefits do you think should be reduced? The largest of these is education, and I suppose you have to count that as a social benefit.

Mr. Griffith: Well, I would think so.

The Chairman: I take it the question is optional, by which I mean the witness may opt not to answer, which he does.

Senator Connolly (Ottawa West): Mr. Chairman, could I ask these gentlemen a further question?

Senator Everett: Mr. Chairman, I wonder if I could complete this point before Senator Connolly asks his question? You make the point that the tax on income should not be generally harsher than that of the United States. How then do you propose to make up the difference that is required?

Mr. Karr: May I speak to that, senator? I do not think we are saying quite that. What we are saying is that the Canadian tax system should not be significantly different. We are not intending to say that the tax load on any particular person, related to his counterpart, say, in the United States, should not be heavier; there is no intention to say that. Obviously, we have lived beside the United States for many years and have found ourselves living under somewhat less affluent circumstances than they do, so that you have to recognize there is a difference, and probably the difference will remain for a good long time. But what we are saying is, let us not exaggerate the existing difference so that you get results that influence people to leave Canada of that influence the steel industry to invest in mining operations in the United States, and this kind of thing.

Senator Everett: That is the question I am asking, how do you propose to reduce that difference?

Mr. Karr: I am not sure we are proposing it.

Senator Everett: You say the difference should not be too great. The authors of the White Paper propose a system which obviously indicates it has to be very great if you try to impose all the taxes the way they want to impose them. You say they should be reduced, quite properly, but where do you then impose the tax?

Mr. Karr: We have a tax system we are living or existing under, and therefore there is a status quo. What we are trying to say is, let us not shift a whole lot of things in the name of equity because, we are not sure where those taxes will end up anyway. I do not think this necessarily means you have to find an extra amount of revenue somewhere.

Senator Everett: I will ask one last question. Your point is very well taken, but would you think that more consideration should be given in Canada to value-added taxes?

The Chairman: This is an optional question, I take it.

Mr. Karr: I should say that Canada should study it very carefully.

Senator Everett: We should study them very carefully?

Mr. Karr: Like any other innovation, an innovation of this kind may seem very attractive, until you get down to operating it.

The Chairman: Are you saying that we have enough innovations in the White Paper that we should not start looking for more at this time?

Mr. Karr: If we have innovations, let us take them slowly.

The Chairman: I think we have pretty well exhausted this submission.

Senator Connolly (Ottawa West): Mr. Chairman, I have one question. Has the Steel Company any foreign subsidiaries?

Mr. Griffith: Yes.

Senator Connolly (Ottawa West): Is this generally so for the steel industry in Canada, to have foreign subsidiaries?

Mr. Brown: I think largely to the extent that the mining operations in the United States have become a foreign subsidiary. In other words, we have coal mines in the Unites States and other mining interests, and they are grouped together in a subsidiary. We have the other foreign subsidiary Mr. Karr mentioned, the sales agency in Europe.

Senator Connolly (Ottawa West): I read an article not too long ago by a man called Leighton who said that business in Canada, and especially large enterprise in Canada, is going to have to face and become involved in the establishement of multi-national corporations, that this is going to be the trend. I would assume an industry as important as the steel industry would have to look at this proposition and see whether it was viable for you.

I also noted, reading a publication of the Private Planning Association on Canada's Trade Policy in the Second Development Decade, on page 57, one of the suggesstions made by this organization—which is not a governmental organization but is run out of the private sector—is this:

> Why not move Canadian plants to the developing countries to permit Canadian enterprises to share in the advantages of low wages.

They are talking there primarily about things which are not indigenous to Canada, like the steel industry and industries basic to it, namely the iron ore industry. But in the event of the taxation proposals of the White Paper becoming too onerous upon continued operations in Canada, would you say there is a possibility that the steel industry in Canada might adopt the course proposed by the Private Planning Association and perhaps establish foreign subsidiaries in order to take advantage of lower rates of taxation abroad?

Mr. Brown: I think it comes back again to the question of earning money on your investments or on the cash the company has. If doing business in Canada is more profitable than doing it in the United States, Australia or elsewhere, we will do business in Canada. But if the tax laws change to the extent that discourage expansion in Canada or make it more difficult, then are we not going to be induced and encouraged to look elsewhere, to diversify and look abroad for opportunities to increase our return on investment?

The Chairman: Would you say there are opportunities abroad?

Mr. Brown: Yes, I think there are.

Senator Connolly (Ottawa West): Suppose you do this and then you start repatriating the profits that you make, you are penalized, of course, again under the proposals of the White Paper.

The Chairman: Well, of course, senator, they would not have to bring it home.

Senator Connolly (Ottawa West): No, but if they do, this is so.

Mr. Brown: The real dilemma is this in our industry, that looking ahead the amounts of money required to expand our plants, in keeping with the projections of increased steel demands, are so large that anything which reduces our ability to generate cash internally, or makes it more difficult to raise cash through debt or equity, will affect our plans. So that is our dilemma, and the main reason why we are so concerned about this iron ore situation. We feel that this could have a very serious inhibiting influence on the growth of our industry during the seventies, and we certainly have to keep growing and replacing our equipment, and the pace of technology requires that we replace it quickly to be competitive.

There is one other thing, referring to this report you quoted from: Surely, we are Canadian companies and our heart remains in Canada. We would prefer to stay here and create more jobs for Canadians.

Senator Connolly (Ottawa West): I would like to ask one further question, if I may, Mr. Chairman. I remember in the early days of the war, when the War Committee of the Cabinet had to consider the question of increasing steel production in Canada for the war effort. The steel comptroller then was Mr. Hugh Scully and he thought it might be desirable, instead of getting perphas a 100 or 200 per cent increase in

Canadian steel production, to arrange with the Americans to increase by 1 per cent and get that extra sources of supply, and that would do it. In fact, the first course was adopted and incentives were provided at the mining level and other tax incentives to the steel industry. Has the industry grown in that period, from say 1935 to 1939 to the present time?

Mr. Brown: Has it ever.

Senator Connolly (Ottawa West): What is the percentage of the increase?

Mr. Brown: It has grown at least ten times since 1935.

Senator Carter: On page 5 of your brief you state that Stelco's plans for expansion for the next 10 years are estimated at over $1 billion. Could you give the committee some idea of how that figure will be curtailed if the present proposals go into effect?

Mr. Griffith: I will make a comment, but I do not know whether I can answer the question in complete detail. However, for example, we are holding up a $200 million project at the present time. We just do not know what to do about this, because with the possibility of added taxes and this sort of thing, plus the inflationary costs in the construction business, it does not appear to be a practical thing to do. We have to wait and attempt to evaluate. This is just a beginning of this program.

In my remarks I said that by 1980 we hoped to be at about 9 million tons of capacity. We are under just about 5 million tons at the present time. We are expanding our facilities at our main plant to increase that capacity to 6 million tons, but whether we can go forward from 6 million tons to 9 million tons depends a great deal on taxes and the cost of building these very expensive capital units.

The Chairman: We have about exhausted this submission; I hope we have not exhausted you in the process. Thank you very much.

We proceed now to the submission of Dominion Foundries & Steel Ltd.

Mr. Sherman, you have with you Mr. Sheppard and Mr. Laing. Do you have a summary statement to make?

Mr. F. H. Sherman, President and Chief Executive Officer, Dominion Foundries and Steel Limited: Thank you, Mr. Chairman. I would like to draw you attention to several points in the brief. A very major point with us is should the White Paper become law in its present form, it would have a drastic effect on lump-sum withdrawal payments from our employees' profit sharing fund. Our employees reacted swiftly and with great concern to the proposed change. We are here today to plead before this committee, not only on behalf of the Dominion Foundries and Steel, but also on behalf of its 5,700 profit-sharing employees. We can see no rational argument in favour of the proposed changes which, in practice, would more than double the taxation on lump-sum withdrawals. From the point of view of government revenue, we commissioned an actuarial study, which I believe you have. This shows clearly that an employee would pay about the same tax to the Government by taking a lump-sum withdrawal payment under the present system than he would should he decide to take his money in the form of an annuity.

Another argument put forth by some of the members of Government is that some employees would mismanage the sum they receive on retirement and eventually become public wards. I'm proud to say that, to our knowledge, no retired employee of Dominion Foundries and Steel has ever been a public ward.

We consider this to be a most serious matter for all employees of profit-sharing companies, where by and large the management-employee relationship over the years has been excellent.

We have already commented on the proposed changes in mining taxation. We would also like to bring to your special attention the section of our brief that deals with the integration of corporate and personal income taxes.

The proposal to ". . . . offer a substantial inducement for Canadians to invest in Canadian business . . ." is important to us. We will have to build many more plants to supply the expanding steel markets of the next decade. If we have to sell shares to finance this expansion, then any encouragement for Canadians to buy our shares would help increase Canada's productive capacity.

The best way to encourage Canadians to buy share in Canadian companies is through the present dividend tax credit. It has worked well. It is easy to understand. It results in the shares of all kinds of companies being equally attractive from a tax point of view.

You have heard and will hear from others about the complicated and impracticable aspects of the White Paper proposals for the taxation of shareholders. Our brief gives our impressions on the disadvantages of the proposed arrangement. It is because of the advantageous features of the present method of providing

incentives for investment by Canadians in Canadian companies that we urge the increase of the present dividend tax credit from 20 per cent to 30 per cent.

Perhaps our biggest concern about the White Paper is not so much what it says directly, but what it implies. Its underlying theme assumes, in our view, the acceptance of a political philosophy which would permit and encourage governments, at all levels, to continually increase their revenue and expenditures to do "useful and important things."

I had a few other general comments, but I will pass those in view of spending time on the more important items.

The Chairman: Would you care to say something further with respect to your profit-sharing plan?

Mr. Sherman: This was a very far-sighted plan which was started back in the late thirties. All employees today contribute 5 per cent on the same basis of their income, to a maximum of $200. The company puts in 11 per cent of its pre-tax profit, to a maximum of six times the contribution of the employees. The first three times the company puts in goes to our original fund, which is invested as a retirement plan. Any amount over and above the three to one goes into a deferred plan where the employee has the choice of taking a yearly cash payment or having it invested further for him.

This plan has been very successful over the years. It is widely known across Canada, and at the present time has assets of over $70 million. It is one of the foundations of the success our company has had in our good employee relationships over the years. This is why we are so concerned about this one aspect of it, because one of the strong points to our people is the very fact that when they come to retirement they have the choice of how to take their money. They do not have to take an annuity if they do not need it. They can take it in cash; they can take it in part cash, part annuity; in other words, they can decide how it best suits them. The proposed change, which would double the tax rate on lump sum withdrawals would, we are afraid, have very serious effects on this attractive feature of it.

The Chairman: Going over the past years, how would it work out percentagewise between those who take lump sum payments and those who elect to take an annuity?

Mr. J. G. Sheppard, Executive Vice-president (Financial): The great majority of them have taken lump sum payments. Mr. Sherman indicated earlier that we know of no cases where they have become wards of the community or wards of the state. We think it would be a rather cruel joke, for example, to insist that a man of 65 with a credit of $40,000 or $45,000 who develops terminal cancer be forced to take a life annuity. It just does not make sense to us. We have placed before you a letter from William Mercer Limited, who are outstanding actuaries, which indicates that for a man with $40,000 and an average income of $10,000 a year in the previous three years, the tax the Government would get in his taking a lump sum payment is greater than if he took an annuity, so we see no valid reason for it.

The Chairman: On pages 14 and 15 of the brief there is a calculation of the income tax payable on a lump sum payment out of a pension plan on the present income tax basis and on the basis of the proposals in the White Paper. They have made certain assumptions there; that is, that the person receiving the $45,000 lump sum payment had an income of $9,000 a year in the four years prior to retirement; he is married with no other dependants and he retired on January 1. The calculation on the basis of the proposals in the White Paper is after full implementation of the proposals, after any transitional period. You see under the present income tax basis, following the arithmetic, the total tax payable would be $8,343. If you look at the White Paper basis of calculation, the total tax on a lump sum payment of $45,000 would be $15,824, so it shows very graphically the impact of the proposed increase.

Senator Phillips (Rigaud): I am not too clear. I am following you, Mr. Chairman, on those parts of the brief, but I am not too clear from the Mercer letter whether this is an analysis of the adverse effects that would result from the implementation of the White Paper.

Mr. Sheppard: That is correct.

Senator Phillips (Rigaud): Because the body of the letter does not say. With that understanding and clarification, may I move that this letter be deemed to be part of our record today and form an appendix thereto?

The Chairman: Are you satisfied to have it attached?

Senator Phillips (Rigaud): Attached to the brief.

(See Appendix "E" for letter from William M. Mercer Limited).

Mr. A. D. Laing, Assistant to Executive Vice-President (Financial), Dominion Foundries & Steel Ltd.: Could I speak to that comment, Mr. Chairman, for a moment?

The Chairman: Yes.

Mr. Laing: The purpose of this letter is not so much a comparison of the White Paper basis with the present basis, but rather seeing what the tax payable on a lump sum is on the present basis compared with what the tax would be if the person took an annuity on the present basis.

Senator Beaubien: This is all on the present basis.

Mr. Laing: Yes.

Mr. Sheppard: The Mercer letter is on the present basis. The White Paper leaves no basis but to take an annuity, unfortunately. This applies to anybody. This is the point we are making. There is really no option. The averaging provisions are really meaningless for the average person. We have suggested in our brief that lump sum payments be taxed at 15 per cent, which is about what it is under section 36, but it is an easily understood amount and everybody would know where they stood.

Senator Connolly (Ottawa West): In the event of a man taking an annuity and then not surviving for very long, does the balance of the money, which is vested in him, I assume, in the fund, go to his estate?

Mr. Sheppard: No, sir. It depends what annuity he takes. He has the choice of indicating to the trustees which type of annuity he wants—a life annuity, joint survivorship, ten-year guarantee—so there is no set pattern.

Mr. Laing: May I speak to that one, too? The fund is not paying an annuity to the pensioner. The person retiring buys the annuity with the money he has to his credit.

Mr. Sheppard: The trustee buys it on his behalf, on his instructions.

Senator Hays: How is a similar situation treated in the United States?

The Chairman: I think there is a higher rate. Do you know what it is? Mr. Gilmour says it is 25 per cent.

Mr. Gilmour: A lump sum withdrawal falls into the category of a long term capital gain. There is an option in dealing with these sums. Half of the lump sum payment can be paid into the income and the tax computed, or a flat rate or 25 per cent can be applied, and whichever is the lower is paid. In other words, if the top rate of tax is less than 25 per cent, the top rate of tax is paid on the lump sum. If putting half the lump sum on top of the regular income produces more than the marginal rate or 25 per cent, it is a flat rate or 25 per cent.

Senator Hays: If there is no capital gain in the United States this would not happen.

Mr. Gilmour: No. They have deliberately elected to treat a lump sum withdrawal as a capital gain. Under our proposed system this lump sum withdrawal falls into the income. Then we have this most inadequate averaging proposal which, as the illustration shows, will take well over 33 per cent of a man's life saving in his pension plan.

Senator Connolly (Ottawa West): Am I right in saying that when the man comes to retirement and decides for either a lump sum payment or an annuity, or one of the various options already described, in any event he will be taxed on the withdrawal?

The Chairman: At the time of the withdrawal.

Senator Connolly (Ottawa West): At the time of the withdrawal. Even if he elects to take an annuity in one form or another?

Mr. Gilmour: Not necessarily. It has to depend upon the type of pension plan.

Senator Connolly (Ottawa West): In other words, he would not be taxed twice. If he takes an annuity, he has $45,000 in there, what he will be taxed on is what he draws on that annuity, and if there is the survivor benefit what his wife draws.

Mr. Gilmour: That is right.

Senator Connolly (Ottawa West): As they get it.

The Chairman: That is right.

Mr. Gilmour: He normally has to make that choice some time prior to retirement. He elects which he is going to take, the normal pension, a lump sum if he is entitled to it, or the annuity. In any event he should not be taxed more than once for what he receives.

Senator Hays: As far as the trust is concerned, that would also be taxed—you say $70 million under the White Paper.

Mr. Gilmour: The income of a pension trust under the White Paper continues to be free.

Senator Phillips (Rigaud): May I make some suggestions from the point of view of time. Would you be good enough to turn, honourable senators and gentlemen, with me to page 3 of the brief where we have reference to 4.19 to 4.45 of the White Paper. It deals with the subject-matter of taxation of shareholders. May I suggest that Mr. Sheppard read that portion of the brief, which takes you to the end of page 4?

Mr. Sheppard: The White Paper proposes an inducement for Canadians to invest in Canadian business. The method proposed to achieve this goal is not practicable because:

(a) The suggested system of integration is so complex that many company Directors will find it difficult to understand, let alone the average shareholder.

(b) Under the suggested system there could well be a conflict between tax planning and what would otherwise be appropriate business policy with respect to dividends. The introduction of stock dividends strikes us as being artificial.

(c) The proposed 2-1/2-year period in which dividends must be paid would create great administrative difficulties.

(d) Integration would reduce the effectiveness of tax incentives.

We suggest that the objective of encouraging investment in Canadian companies could better be achieved simply by increasing the present dividend tax credit to an appropriate percentage, possibly 30%. It would also make the taxation system easier to understand.

Dividends between taxable Canadian corporations should continue to be exempt of tax to the recipient corporation.

We know that the implementation of the above mentioned proposals may cause a reduction in revenue. It seems that increasing the tax burden on other groups was viewed by the authors of the White Paper as the only solution to that problem. We suggest that solving it by curbing government expenditures should be viewed as a viable alternative. All government expenditures should be reviewed, with a view to maintaining only those programmes which are essential and meet the needs of today's society. Also, all political parties should refrain from recommending additional expenditures for the sake of political expediency. The business community would be pleased to provide personnel who could make specific suggestions on how government expenditures might be cut back.

Senator Phillips (Rigaud): Will you be good enough to turn to page 9 of the brief where reference is made to 4.19 to 4.45 of the brief which deals with the subject matter of taxing unrealized gains. This ends at the top of page 10.

Mr. Sherman: The proposal to tax unrealized capital gains in shares of widely-held Canadian companies every five years is nothing short of confiscatory. This could result in a shareholder being forced to sell stock to pay the tax on it as well as cause company owners to lose control of the company they worked hard to establish. In addition, it would make it more difficult for Canadian companies to raise capital by selling shares.

The proposal should be abandoned.

We suggest that, if it is felt necessary to introduce a capital gains tax, it should not be more onerous than in the U.S. where only realized gains are taxed.

The Chairman: I notice, just pausing for a moment, that at the bottom of page 9 the conclusion reached is very bluntly stated, that the proposal should be abandoned.

Senator Phillips (Rigaud): Yes. It may be one of the reasons why I am suggesting its incorporation. May I ask you to be good enough to turn to page 11 of the brief where reference is made to 4.43 to 4.45 of the White Paper. This deals with the subject-matter of closely-held corporations. I would like Mr. Sheppard to read this.

Mr. Sheppard: In the proposals, important distinctions are made between closely-held corporations and widely-held corporations. These distinctions are oversimplified and arbitrary and cannot be accepted as a basis for tailoring a tax structure. Shareholder and management participation is not confined to closely-held corporations. Some widely-held corporations are actively controlled and managed by small groups of shareholders. Furthermore, these two types of corporations often compete with each other, and the proposed new system could give one an unfair advantage over the other.

Senator Phillips (Rigaud): Last, but not least, there is an item, which as you know, Mr. Chairman, has received the attention of honourable senators and it concerns them. That is on page 12 of the brief, under the heading "Agreement with Provinces." We have there a vital three-line paragraph:

> As a final and vitally important point, we suggest that no major tax reform be undertaken at the federal level without prior agreement with the provinces.

The Chairman: Mr. Sherman, we had the benefit of a brief discussion with the mining industry and then with Stelco. I do not want you to feel that we are running out of time, because we are not. We are going to sit this afternoon as well. Have any senators questions they would like to ask?

Senator Desruisseaux: I presume that they have a union just the same as anyone else. I would like to know whether this pension situation created by the implementation of the White Paper has been discussed in the company of the employees.

Mr. Sherman: I did not hear that.

The Chairman: He wants to know whether your pension plan and the effect the White Paper will have has been discussed with your employees.

Mr. Sherman: Yes, they get an annual statement of how much money they have in the fund. I referred to it in the report they got this year, and I quoted two examples, that the tax would be doubled. The result was consternation throughout the whole plant, as you can imagine, and I believe many of them have sent letters to their members of Parliament. They all know that we are down here on this subject and they are vitally interested in it. In fact, some of them are so concerned that if they are near or within a few years of retirement age they are considering quitting their job now.

The Chairman: Is that the only way they could withdraw, by quitting their job?

Mr. Sherman: Yes.

Senator Desruisseaux: They were not prepared to present a brief on that, themselves, as a union?

Mr. Sherman: Perhaps they will at a later date. They are vitally concerned. They are waiting to hear from us as to what they should do next.

The Chairman: There is nothing like hearing from the people who are directly affected.

Senator Connolly (Ottawa West): Would you say that most of your employees fall into the category which is generally described as the middle-income group?

Mr. Sheppard: I would like to ask what you mean by "the middle-income group". I have heard many definitions.

Senator Connolly (Ottawa West): I think we have a little difficulty trying to delineate the limitations.

Mr. Sheppard: You are talking about $8,000, $9,000 or $10,000 a year?

Senator Connolly (Ottawa West): Up to $15,000 or $20,000.

The Chairman: You are talking in the area of from $8,000 to $12,000.

Senator Connolly (Ottawa West): The majority of your people fall into that category.

Mr. Sheppard: The great majority.

Senator Molson: Do you have any strong views on the low rate of taxation on the small corporation, the 21 per cent on the first $35,000.? Do you feel that it should be continued?

Mr. Sherman: Our only view on this particular point is that it would directly affect our small customers. I believe Stelco made the same point that the young business starting up, to some degree, needs encouragement, because it is always short of money and on the verge of going broke. I would say that that is our interest in it.

Mr. Sheppard: The reason no union has put in a brief is that we have no union in our company.

Senator Desruisseaux: You have no union whatsoever?

Mr. Sheppard: No.

Senator Molson: How many employees do you have?

The Chairman: There are 7,000.

Senator Everett: Mr. Sherman, under the heading "Mining and Petroleum" on page 5 you state:

> Canada would not be well served by the implementation of this proposal, especially when one considers that no additional revenue is indicated as a result of the change.

Could you explain that statement?

Mr. Sheppard: Inside the back cover of the White Paper there is no indication of any additional revenue. We have seen the results of no studies that have been made by the department, which indicate what the effect of all of these changes in mining tax legislation would be.

Senator Phillips (Rigaud): That is a new point we have not heard.

The Chairman: When Noranda was here they indicated that there would be approximately a 25 per cent increase in their tax following the White Paper, as against what they pay at this time.

Senator Everett: In fact, you believe there is an increase in revenue?

Mr. Sheppard: We know from our own studies there has been an increase in revenue averaging $5 million or $6 million a year.

Mr. Laing: To speak to your point—this is partly in the White Paper—the transitional period of 1975 on the proposals with respect to mining income. . .

Senator Everett: To make the point you are making as a company, and indeed that your industry is making, there is a very definite increase in the revenues to the Government which, in effect, causes a very definite decrease in the return on your investment.

Mr. Sheppard: That is correct.

Senator Phillips (Rigaud): What is the percentage of increase? You mentioned a figure in millions of dollars. What would be the percentage of increase compared to taxes on the present basis? I think you mentioned a figure, that would cost so many millions of dollars, but I am trying to get a percentage, roughly.

Mr. Sheppard: Possibly it woud be a 20 to 30 per cent increase.

Senator Phillips (Rigaud): That is what I wanted.

Senator Everett: There is another question, referring to a statement on page 11, in which you say that the competition between closely held and widely held corporations, under the White Paper, would be unfair. If there were a separated capital gains tax, and if intercorporate dividends were tax free, would you think that statement would still hold? And, if it does, where does that unfair competition take place?

Mr. Sheppard: There is one technical aspect—possibly a minor one. Even with the separated capital gains tax, one advantage available to closely held companies is a partnership option. If it can meet the conditions laid out in the White Paper, there is still that advantage.

Senator Everett: That is well taken. But, beyond that, is there any other, in your mind?

Mr. Sheppard: When you eliminate the capital gains you open up the type of things that we were dealing with, in connection with the shareholders of closely held and widely held corporations.

Senator Everett: We are not dealing with the shareholders at the moment, just with the corporations—the competition which exists between two corporations, one being a closely held corporation and the other a widely held corporation.

Mr. Sheppard: The only one I can state is that of the partnership option.

Senator Everett: Thank you very much.

The Chairman: Is there anything further?

Mr. Sheppard: No, Mr. Chairman, except to emphasize how seriously we view this proposed change in the taxation lump sum payments that is provided in the plan.

The Chairman: I think that is properly a matter of great concern. It concerns us. We wish to thank you for your contribution.

Mr. Sheppard: Mr. Chairman, our conclusion is:

We have presented these views in a spirit of constructive criticism and with the desire to co-operate with all levels of government in helping to improve the standard of living of all Canadians. We are concerned not only for the self-interests of the Corporation we represent, but for the country as a whole. This is why we seriously question whether government should be spending on behalf of the citizens, such a high percentage of our gross national product. We accept the fact that the individual citizen has to give up some of his freedom for the common good. We are convinced, however, that if too much freedom is forfeited, the common good is no longer served. We have reached that point. The proposals of the White Paper on Taxation which would have the eventual effect of increasing our taxes, would take us beyond that point.

The Chairman: Thank you very much. We will reconvene at 2.15 p.m. to deal with the submission by Gulf Oil Canada Limited.

The committee adjourned.

Upon resuming at 2.15 p.m.

The Chairman: Honourable senators, I call the meeting to order. We have one brief this afternoon, that of Gulf Oil Canada Limited. The initial presentation will be made by Mr. McAfee, who is the President and Chief Executive Officer of the company. He will then introduce his panel, shortly after which we will be open for questions. Mr. McAfee.

Mr. J. McAfee, President and Chief Executive Officer, Gulf Oil Canada Limited: Mr. Chairman, honourable senators, we very much appreciate the opportunity to appear before you today to present the opinions and recommendations of Gulf Oil Canada Limited on the proposals for tax reform as set forth in the Government's White Paper.

I am accompanied by our Board Chairman, Mr. C. D. Sheppard, our Financial Vice-President, Mr. D. S. Lyall, and our Treasurer and Director of Taxation, Mr. R. W. Cochrane. If it meets your approval, I would propose to begin by outlining our main areas of concern, to be followed by Mr. Lyall, who will amplify some of the points raised. Then, if there are questions, we will all be glad to do our best to provide answers in greater detail.

Since taxation has such a major impact on our economy and on the everyday life of both individuals and corporations, we commend the decision of the Government to issue a paper embodying its tax proposals for full discussion, together with its indicated readiness to make constructive changes where it can be demonstrated that the implementation of its proposals could have harmful effects on the economy.

We believe that any revision to existing tax laws should embody three important principles—fairness, simplicity, and the maintenance of incentives.

Canada's economy is dependent for future growth on proper and adequate incentives to remain competitive and to attract the risk capital required to develop its resources. Any plan that does not accomplish this objective will in the long run be detrimental to capital formation and growth. Economic development is the basis of social development.

Gulf Canada is one of the largest corporations in Canada and is among the three largest integrated oil companies in this country. It has assets invested in Canada of over $1 billion, more that 11,000 employees in Canada, and some 25,000 Canadian shareholders. While approximately 69 per cent of the outstanding shares are owned by Gulf Oil Corporation, a U.S. based company, Gulf Canada operates independently under its own local management in Canada and under the over-all direction of its own board of directors, most of whom are prominent Canadian businessmen.

Gulf Canada's progress is irrevocably tied to the future prosperity of this country, and we are therefore concerned with the application of any tax proposals which may inhibit an adequate level of growth or slow down the pace of development.

In our judgment, Canada is hungry for capital and cannot generate sufficient funds domestically to maintain the high level of investment that is necessary to develop natural resources at an acceptable rate or growth. Foreign competition for risk capital is increasing, and Canada must compete for capital with other countries which offer attactive incentives for investment. It is therefore essential to ensure that any tax changes which are enacted neither descriminate against foreign investment nor unduly reduce Canadian incentives.

As one of the major producers of oil and gas in Canada, Gulf Canada is particularly concerned with those White Paper proposals which adversely affect the natural resource industries both directly by reducing incentives for investment and indirectly by diminishing the industry's ability to retain or attract the capital funds required for a continued high level of investment.

With these preliminary comments, I would like to turn to the main areas which are of concern to Gulf Canada and give you our views and proposals.

As you know, we have intentionally limited our formal submission to those White Paper proposals which have a direct bearing on our Company and on our shareholders. There are a substantial number of other areas of interest discussed in our brief, but I shall limit my remarks now to only the four major points. These are: (1) Depletion Allowances; (2) Integration of Income; (3) Capital Gains Taxation; and (4) the Proposed Taxation of Unrealized Gains.

I do not propose to deal with the technical details of any of these points of concern, but will limit my comments to the general principles involved.

First, and perhaps the most important area to us is that of depletion allowances. The White Paper acknowledges the high risk involved in searching for and developing oil and gas resources and the fact that

without an adequate incentive it will be most difficult to attract the capital needed to continue a high level of exploration and development. We are gratified that the Government, in the White Paper, recognizes that the revised tax system should continue to contain incentive allowances.

However, the proposed basis involving an "earned" concept of one-third of "eligible" expenditures, would, after the transitional period, result in a sharp drop in the amount of the allowance as compared to the present one-third of net production profits. We feel that the proposed basis would be inadequate to continue to attract sufficient capital to attain the desired level of exploration and development activity.

Gulf Canada therefore recommends that the White Paper proposals for depletion allowances be made more realistic by (a) broadening the base of "eligible" expenditures to include all expenditures on exploration and development and (b) permitting an allowance of 20 per cent of gross depletable income limited to 50 per cent of eligible expenditures.

We believe our proposed formula, while staying within the general concepts outlined by the Government, would result in removing anomalies and would provide sufficient incentive to maintain a proper level of exploration and development.

The second important area of concern is the treatment of dividends paid by public companies. While the stated objective of integration is to avoid, at least in part, double taxation of corporate profits, it should be recognized that the result of the White Paper proposals would be to recover from the shareholders a portion of the incentive allowances and grants which are made tax-free to corporations to encourage activities beneficial to the economy. This procedure would seem to negate the whole concept of integration.

For a resource company like Gulf Canada, which is extensively engaged in activities which the Government encourages by tax incentives and hence normally has an effective tax rate lower than 50 per cent, the proposed gross-up and tax credit arrangement could result in a reduction in the level of creditable tax that its shareholders can deduct as compared to other types of industry.

The Government's integration proposals are very complex and would cause substantial fluctuation from time to time in availability of creditable tax due to timing differences, many arising from investment in such assets as pollution control equipment and depressed area plants, both of which attract accelerated capital cost allowances. To avoid such a situation, we believe consideration should be given to alternative proposals which are simpler and more equitable as between corporations and which would avoid varying impacts on shareholders.

Gulf Canada therefore recommends continuing the present tax credit system but at a higher constant rate of 25 per cent or at a variable rate giving slightly larger credits to lower income shareholders. Intercorporate dividends should continue to be exempt from tax.

The third area is that of capital gains and losses. Gulf Canada appreciates the need to broaden the tax base but has reservations as to the method and scope of the White Paper proposals.

We submit that the tax arising from realized capital gains should not exceed that levied by the United States, our chief source of investment capital. It would be wise, we feel, to approach the taxation of capital gains cautiously and levy lower rates until the economic impact of such taxation can be determined. Certainly to levy a higher tax than that or our trading partners in the free world would be dangerous and would jeopardize the investment flow urgently needed for the development and economic growth of Canada.

We therefore propose that on all appropriate assets, including shares of companies, a maximum of one-half of realized gains or losses be taken into income for tax purposes.

Finally, with respect to taxation of "deemed" gains we are opposed in principle to any taxation of unrealized gains, and we strongly oppose the proposal to tax deemed gains on public Company shares every five years. We feel that such taxation would be impraticable to administer and would cause extreme hardship and inequity. Among other considerations, market prices of shares fluctuate widely and are not a very reliable indicator of the true value of a company. In cases where shares would have to be sold to pay the tax, the effect could be consfiscatory.

My remaining remarks will be directed to three other areas of concern—mining incentives, proposed revisions of the capital cost allowance system, and our belief that any new system be simple, certain, and administratively sound.

Gulf Canada is involved in mining operations in Canada through its participation in the activities of Syncrude and Gulf Minerals Company. Since these companies are presenting briefs directly to the Government committees, we will make only a passing reference to this important resource area.

It is regrettable that mining and petroleum are, throughout the White Paper, dealt with as one subject.

Actually the factors affecting the development and economics of these two industries are quite different and should be considered separately. Petroleum companies deal with many properties across vast areas and exploration and development costs are continuing major components of their operation each year. This situation is substantially different, at least in degree, from normal mining operations. Both industries are risky and both require adequate incentives if they are to attract sufficient investment to ensure maximum development of Canada's vast natural resources. But incentives which are appropriate for petroleum companies are not necessarily appropriate for mining activities, and vice versa.

We are also concerned about the Government's intention, as stated in the White Paper, to solicit views from industry and from the public generally on the capital cost allowance system before major changes are considered. If this announcement implies that the Government intends to revise the capital cost allowance system, it is unfair to ask corporate taxpayers to give meaningful consideration to tax reform proposals without some knowledge of possible changes to this important area. The burden of taxation cannot be properly assessed when such possibilities exist. This concern would apply also to any ultimate revision of the Excise Tax Act.

In rounding out our recommendations for fair and constructive alternatives to the White Paper proposals, we urge that the tax system eventually adopted for Canada possess three important attributes–simplicity, certainty, and administrative soundness.

Many of the Government's proposals seem to be unnecessarily complex, perhaps as a result of trying to eliminate every "leak", regardless of how little revenue may be involved. While perhaps technically desirable, it is doubtful from a practical viewpoint that such a system fits a free-enterprise system composed of human beings. Simplicity is imperative if self-assessment is to work, and Gulf Canada has tried throughout its brief to propose simple, straightforward alternatives, with this consideration in mind.

In concluding my introduction, I would like to reiterate our primary concern that certain of the White Paper proposals such as downward revision of incentives, taxation of unrealized gains, and complex dividend integration would seriously jeopardize the petroleum industry's ability to attract the capital necessary for us to make our optimum contribution to Canada's economic growth and prosperity.

We wish to thank the committee for hearing our thoughts on these important proposals, and we hope that our recommendations will be given serious consideration.

I would like now to call on Mr. Lyall to discuss these and other points in somewhat more detail. My colleagues and I will then be glad, if it is the wish of the committee, to review our brief in detail and answer any questions you may have.

Mr. D. S. Lyall, Vice President, Finance, Gulf Oil Canada Limited: Mr. Chairman, honourable senators: Again without going into any great detail I would like to expand a little bit on some of the areas of concern that Mr. McAfee has touched on in his introductory remarks.

First of all, as he has indicated, it is reassuring to our company and to the industry that the White Paper has recognized in the area of depletion allowance the necessity for a continuation of incentives for exploration and development for oil and gas.

Secondly, they have recognized the anomaly or inefficiency in the present system of depletion allowance, as a result of which the allowance is reduced as the level of expenditures on exploration and development is increased.

Further, they have provided a measure of relief from this anomaly in permitting the carry-forward of unused deductions for earned allowances to subsequent years but, of course, this does not completely eliminate the inefficiency.

If these two basic considerations are recognized as the starting point, the two main points to be considered in any proposed reform of the depletion allowance are: (1) What form should the allowance take to achieve maximum efficiency in achieving the objective for which the incentive is extablished? (2) The adequacy of the incentive in relation to the risk involved in the activities which it is intended to encourage.

On the first point, of the form of the incentive, Gulf Canada is prepared to accept the concept of an "earned" depletion allowance put forth in the White Paper, under which the allowance is more directly related to the activity which it is designed to encourage. However, I wish to emphasize very strongly that our acceptance of this concept is subject to two most important provisos. The first one is that with respect to income from oil and gas reserves which have been discovered there should be a reasonable transition period to minimize the retroactive effect on income from production which represents the successful result of exploration and development activity undertaken in prior years under the incentive of the present tax system.

The second important proviso is that eligible expenditures for the purpose of earning depletion allowance should include all expenditures which are essential to exploration and development unless some obvious loopholes might be created.

Finally, the earned allowance must be adequate in the sense of providing a real incentive to undertake the activity which it is intended to encourage, and the relation to the amount of available resources which must be devoted to the activity to earn an adequate allowance.

The White Paper proposes to limit the amount of the allowance which can be claimed in any year to one-third of production profits in the year after deducting eligible expenditures. Where this limitation would apply it would continue the anomaly of the present system at least to the extent of deferring to some time in the future the right to claim the allowance which the expenditures have earned. Of course, the maximum allowance that could be earned under the proposed system would never exceed one-third of the net income, regardless of the amount earned through eligible expenditures.

To eliminate this anomaly completely we recommend that any income limitation be based on gross income and suggest that 20 per cent of gross income from production after deducting royalties would be an appropriate limitation.

On the question of the adequacy of the incentive, we recommend first of all that the base of eligible expenditures which earn depletion allowance should be broadened to include all expenditures necessary for exploration and development.

Certainly we can see no reason or justification for excluding from "eligible" expenditures the cost of acquiring mineral rights directly from the Crown, and, for the reasons set out on pages 12 and 13 of our submission, we recommend that expenditures for well-head and associated equipment and for gas plant facilities should be included in "eligible" expenditures for the purpose of earning depletion allowance since these are necessary expenditures in the development of oil and gas reserves.

From the table at the foot of page 15 of our submission it can be seen that after the transition period there would be a very sharp reduction in the allowance proposed in the White Paper from the allowance available under the present system unless expenditures for exploration and development were continued at a level, which over an extended period, must be considered unrealistically high.

In fact, as the table on page 15 shows, eligible expenditures would have to be maintained at the level of not less than 40 per cent of gross income after royalty in order to earn an allowance equivalent to the allowance available under the present system. As has been pointed out in earlier submissions to the committee, in order to maintain expenditures at this level, a taxpayer would have to reinvest on a continuing basis one and one-half times his net cash flow after income taxes.

We think this is unrealistically high by any standard and, accordingly, recommend that the amount of allowance earned should be increased from $1.00 of allowance for each $3.00 of eligible expenditures as proposed in the White Paper, to $1.00 of allowance for each $2.00 of eligible expenditures. Even on this one for two basis, in order to earn an allowance equivalent to the allowance available under the present system, the taxpayer would have to maintain expenditures at the level of 32 per cent of gross income after royalty (compared with 40 per cent under the White Paper proposal), and in order to maintain expenditures at this level would have to reinvest on a continuing basis 100 per cent of his net cash flow after income taxes.

If expenditures drop below this level, as they would have to do eventually if the taxpayer is to stay in business, the amount of allowance earned would drop accordingly below the amount available under the present system.

Generally, on the question of what constitutes an adequate incentive for exploration and development it is very difficult to give any firm answer. This can only be determined by experience and can vary from time to time. For example, after a long period of discouraging results as the petroleum industry in Canada has experienced more than once in its comparatively short history, the need for incentive for continuing a high level of capital investment in exploration and development will be much greater than would be the case if the industry has enjoyed a recent period of success.

The recommendation made by Gulf Canada that depletion allowance be calculated on the basis of 20 per cent of gross income after royalty, limited to 50 per cent of eligible expenditures, is one which we think would provide a reasonably adequate incentive subject to the provisos we have mentioned of a reasonable transition period to minimize retroactivity and broadening of the base of "eligible" expenditures which would earn depletion allowance . . .

The Chairman: Mr. Lyall, when you speak about this basis of 20 per cent depletion you say that would be a

reasonable incentive. Who are you speaking about—company or the shareholder?

Mr. Lyall: I was thinking essentially of the company from the standpoint of the capital investments.

The Chairman: If you have to get risk capital you have to pay more for it or hang up inducements that are more attractive. Therefore, in looking at the question of incentive depletion allowance that could constitute a proper incentive should you not look at not only what the company will be able to get along with, but what reward the shareholder is going to get.

Mr. Lyall: Yes.

The Chairman: Do you think that what you have proposed is reasonable when you apply it to the facts that I have stated—that is, the position of the shareholder as well as the person who advances debt money?

Mr. Lyall: From this standpoint, sir, I think we felt that again it would be the intention of our company to continue a high level of exploration activity and that this 20 per cent would be—and I stress this again—subject to the provisos we mentioned. It would be one that would provide an adequate incentive for us to continue the level of activity that we have had.

The Chairman: What is your effective rate of tax now under the present law?

Mr. Lyall: Our tax provisions, sir,—this of course always raises the question of this deferred tax allowance—in 1969 was about 32 per cent.

The Chairman: If the White Paper proposals are implemented what would the rate be?

Mr. R. W. Cochrane, Treasurer and Director of Taxation, Gulf Oil Canada Ltd.: Looking at the effect of the White Paper on depletion and production profits and isolating these, and assuming that the White Paper is fully in effect, taxes for 1969 would have increased by 23 per cent and our depletion allowance would have been raised by 45 per cent.

Mr. Lyall: What Mr. Cochrane is referring to are the taxes on production earnings.

The Chairman: That gets up to 55 per cent. By the alternative suggestions you have made what rates would result?

Mr. Lyall: This again would depend upon the level of exploration and development activity which is continued. If that were at the same level as in recent years we would expect that our rate would be in the order of magnitude of 32 per cent, which we had last year, or somewhere in that area. It is difficult to put any precise figure on it.

The Chairman: I was wondering how you could expect to continue for any length of time spending 100 per cent of your income on exploration and development.

Senator Connolly (Ottawa West): I had difficulty on that point too.

The Chairman: I am wondering what attraction there would be to risk capital on that basis.

Senator Connolly (Ottawa West): Did you imply that the 100 per cent would be devoted to exploration, because you talked about income after taxes but you said nothing about after dividends.

Mr. Lyall: What I said was that in order to maintain our depletion allowance on this earned basis at the level that would be equivalent to the depletion allowance under the present system we would have to, under the White Paper proposals, reinvest one-and-one-half times our net cash flow after taxes and, under our own proposals, 100 per cent of the net cash flow. Obviously, you cannot do this. Our hope is that in the exploration end of the business we are going to be successful, and that in the longer run the amount of revenue that will be realized from the oil and gas reserve that we discover will grow and that the dollar amount of the exploration and development activity in relation to that revenue would be a declining percentage of our total revenue.

The Chairman: As the percentage that you spend decreases your exposure to tax becomes greater until you are taxed at the full corporate rate.

Mr. Lyall: That is correct.

Mr. C. D. Shepard, Chairman of the Board, Gulf Oil Canada Ltd.: Both the White Paper proposals and our proposals would result in a reduction in depletion allowance. I think it should be emphasized what Mr. Lyall said earlier that what is adequate incentive is a pretty hard thing to be precise about, and it is a result of experience. This is a matter of judgment. I guess what we are saying is that we think perhaps there would still be adequate incentive at a slightly lower rate of depletion allowance than we are now enjoying, but who knows.

Senator Everett: I wonder if we could have a look at the table on page 9. I will ask Mr. Lyall if he could show us where Gulf stands now on that table in relation to eligible expenditures as against profits before eligible expenditures.

Mr. Lyall: Again, I think we have figures here that answer that question. I should say, first of all, that the answer to the question depends in part on what we recognize as eligible expenditures.

Senator Everett: Let us take your difinition of eligible expenditures, including, I guess, Crown lands and gas plants.

The Chairman: Cost of acquisition.

Mr. Lyall: In the year 1969—and again on what we consider the proper definition of eligible expenditures, including the acquisition costs on Crown mineral rights and the cost of gas plants and well-head and associated equipment—our eligible expenditures, under that definition, would have amounted to approximately 65 per cent. I should say, however, that 1969 was a year in which we had an unusually high proportion of lease acquisition costs and also an unusually high expenditures on gas plant development. If we go back to 1968, the percentage would have been—again, on our definition—about 56 per cent.

Senator Everett: Would you say what the five-year average would be?

Mr. Lyall: I would rather see the five-year average in the past, because over the last five years it probably would have been more in the order of 50 per cent.

Senator Everett: So it is a five-year average that is rising probably in the last few years closer to 60 per cent.

Mr. Lyall: I would not say that that represents a trend because of, for example, gas plant developments. They do not come along every year.

Senator Everett: Is that, Mr. Lyall, 50 per cent of gross depletable income?

Mr. Lyall: After royalties.

Senator Everett: After royalties.

The Chairman: Could we look at what you are saying in the context of the other points that were mentioned by Mr. McAfee, and that is on the question of the tax credit at a percentage rate instead of the integration proposed in the White Paper. Is there a relationship between these different proposals that you are making, or does each one represent your thought in relation to that item no matter what the other items may produce?

Mr. Lyall: You are referring to the present shareholder's depletion allowance?

The Chairman: Depletion allowance, and then the 20 per cent.

Mr. McAfee: The integration.

The Chairman: As against the integration. In which context are you discussing this depletion, now, and your plan?

Mr. Lyall: I think really we are discussing it essentially from the standpoint of a company as a resource industry.

Mr. McAfee: As individual points.

The Chairman: Under what system, so far as their relationship to the shareholders is concerned—under the integration system, or under the depletion allowance in the present law plus 20 per cent tax deduction?

Mr. Lyall: I would answer this way. It would come later on in our brief. We would prefer, on this question of integration, to be staying with the system that we have now. So it is really made in the context of the present system.

The Chairman: Both as to the depletion allowance to the shareholder and the 20 per cent tax deduction?

Mr. Lyall: I think so, yes.

Senator Everett: Mr. Lyall, on the basis of the expenditures that you have given us, if there were some restriction on depletion of 33 1/3 per cent of the net, every year, would not the White Paper be satisfactory to you as a company on the basis on which you are now operating?

Mr. Lyall: No, I do not think so, because of, first of all, all the restrictions on eligible expenditures that are proposed in the White Paper; and, secondly, because of the ratio of only one dollar of allowance for every three dollars of expenditure. We think that would be inadequate.

Senator Everett: Looking at your table on page 15, where the eligible expenditure is 50 per cent, on your definition . . .

Mr. Lyall: Right.

Senator Everett: Would not the White Paper, in that circumstances, give rise to 16.7 per cent—that is, if the depletion were not limited to 33 1/3 per cent?

Mr. Lyall: No, not in that area, because on that line the asterisk there indicates that the net income limitation would apply. In other words, the maximum is one-third of net income, or one-third of 30.

Senator Everett: And if that did not apply, would not the allowance be 16.7 per cent?

Mr. Lyall: Yes.

Senator Everett: And at 60 per cent, the allowance would be 20 per cent, the same as your proposal?

Mr. Lyall: Right, but again I would point out that this represents a very high level of expenditure.

Senator Everett: Yes.

Mr. Lyall: And it is the incentive that would encourage the maintenance of this high level?

Senator Everett: And your proposal of a total of one dollar for two dollars and 20 per cent of the gross depletable income allows you to operate at a satisfactory tax rate, at a lower level of eligible expenditures. Is that correct?

Mr. Lyall: Yes.

Senator Everett: I wonder if I could ask Mr. McAfee if he has any idea what that level should be. You are on 50 to 60 per cent, and you say that is too high on a continuing basis. What should it be on a continuing basis, so we can get an idea of where the emphasis for the best return should be?

Mr. McAfee: That is a really tricky question. I guess we could only draw on the past for guidance there. I guess what we have had has proved itself to be reasonably adequate, and I think if we deviated very far from that we would be playing with fire. Do you agree?

Mr. Lyall: Yes. I think really our recommendation is what we believe is the level that would provide an adequate incentive, but again, as we have said, it is very difficult to say just what is an adequate incentive?

Senator Everett: You, in your very excellent paper, have made a recommendation which would indicate to me that you believe the expenditures of an oil company should be somewhere between 40 and 60 per cent of its gross depletable income after relief.

The Chairman: Do you mean for exploration and development?

Senator Everett: And gas plants and Crown leases. I am not trying to entrap you, but we are looking for what that percentage should be. We want to find out what the best percentage is for oil companies. However, if it is impossible to answer . . .

Mr. Lyall: It is pretty difficult to answer. I think we could say—but again this depends a great deal upon the success that a company has had in its exploration effort—that a company expending, say, only 10 per cent of its income after relief, and further exploration and development, generally would say that is on the low side. On the other hand, a company that was spending, say, 60 per cent on exploration and development would be getting on the high side. I do not think there is any one magic number in between that range.

The Chairman: I want to approach this from another point of view. In view of the proposal you have made, would you say that, under the present rule and the incentives that you have enjoyed and the taxes that you have paid, you have assumed less than a fair share of the tax burden?

Mr. Lyall: No, sir, I would not say that.

The Chairman: Why?

Mr. Lyall: Well, let me put it this way . . .

The Chairman: I am using the language of the White Paper, you know.

Mr. Lyall: I realize that. First of all, when we are talking about a depletion allowance, what we are really saying is that there will be no depletion allowance unless the exploration activity of the company as encouraged by the depletion allowance is successful; that unless the company is able to find some oil and gas reserves and produce some income from which to deduct the depletion allowance, there will be no allowance at all.

The Chairman: You will not have anything.

Mr. Lyall: And really, you have the situation that, if this activity would not have been undertaken without the allowance, then there would have been no tax revenue to the Government at all. So really the depletion allowance is a forgoing of part of the revenue that would normally result at full tax rates in order to produce that revenue for the Government.

The Chairman: There are two things rising out of that. One is the formula you were proposing, which looks to me, and I say this kindly and fairly, like a proposal that would of necessity differ from the White Paper proposal, but which would put you relatively in the position that you are in now.

Mr. Lyall: It would not be too far from that, yes.

The Chairman: That is the effect of what you have said.

Mr. Lyall: But it would eliminate some limitations that we don't think are proper or right at the present moment.

The Chairman: Was the 20 per cent sort of reached because of that being your objective?

Mr. Lyall: Generally I think the answer would be yes.

Mr. McAfee: If I might interject here, Mr. Chairman, there would be the other factor, and we think this is important, of endeavouring to have Canada's depletion provision on an equitable basis with the competition, if you will, which includes of course the United States.

The Chairman: The United States depletion is based upon the gross production income.

Mr. McAfee: That is right.

The Chairman: And if you were operating in the United States, what would be the rate of depletion?

Mr. Lyall: It would be in the order of 20 per cent, I think, on an effective basis, because of course the 50 per cent net income limitation does operate to reduce the over-all effective rate, whereas the statutory rate is 22 per cent.

The Chairman: But the limitation or the ceiling, in other words, applies. Do you export crude to the United States?

Mr. Lyall: Yes, sir.

The Chairman: So you have to compete with whatever the price conditions are there.

Mr. Lyall: Yes, sir.

The Chairman: Therefore the closer you get to the competitive tax conditions in the United States the better you can compete.

Mr. Lyall: That is important, yes.

Mr. McAfee: I might add that this 20 per cent figure, on the basis Mr. Lyall has outlined, in our best judgment considering differences of definitions would be pretty close to the United States nominal 20 per cent, with their definitions.

Senator Everett: Would there not be two advantages from that? The first would be the carry-forward provision which you propose, which I gather is not available to Americans.

Mr. Lyall: I am not certain on that, but I think it is available to them.

Mr. Cochrane: Unless you have 50 per cent of the net, which is maximum, you have to deduct in order to take the depreciation off.

Senator Everett: That is right, because it would be 50 per cent of the net limitation. Would you propose any limitation on the net?

Mr. Lyall: The net income? No.

Senator Everett: Such as the Americans do.

Mr. Lyall: No.

Senator Everett: Even a high one?

Mr. Lyall: No. In fact, the limitation we have proposed of one for two would probably be more restrictive than a 50 per cent net income limitation.

I should like to come back to the other point. I would stand to be corrected here, but again I was under the impression that under the United States system, if a loss were created in any year, that loss could be carried forward. I am not certain of that, however.

Senator Connolly (Ottawa West): How long have these laws been in existence in the United States with respect to depletion? Have they had long experience with them?

Mr. Lyall: I believe so, sir.

Senator Connolly (Ottawa West): Could you say how long?

Mr. McAfee: Since the early 1920s, I believe.

Senator Connolly (Ottawa West): By comparison, what is the length of the Canadian experience in this respect?

The Chairman: We were told this morning, senator, so far as mining was concerned, that in 1935 the tax holiday came in.

Senator Connolly (Ottawa West): But the depletion came in much later for mining. I wonder about the petroleum industry. Did depletion come into the petroleum industry at about the same time as it did in the mining industry?

Mr. Lyall: I could not put an exact date on it, but is has been around so long as I have been in the oil business, which is 20-odd years. I think perhaps it was not a major factor in Canada until 1947, but I believe it is correct to say that the United States system, which has been in effect for many years and certainly goes back to the early 1920s, has proved to be an effective incentive for the industry in that country.

Senator Connolly (Ottawa West): In other words, their body of experience is something which is useful to look at in the North American context.

Mr. Lyall: It should not be disregarded.

The Chairman: But coming back to what we were discussing before, Mr. Lyall, I still don't feel satisfied. The White Paper proposes that you will get one dollar of depletion allowance for every three dollars that you spend on exploration and development. But you say in your proposal that it should be one dollar of depletion allowance for every two dollars that you spend. In one sense each formula is a loser, is it not? Nobody is going to spend 100 per cent or 150 per cent.

Mr. Lyall: That is right, sir. Perhaps I could put it in these terms, that, if we were fortunate enough to make some very major discovery, say, in the Canadian Arctic, that would increase our revenues from oil and gas to the point where what you would consider a reasonable continuing level of exploration activity would be less that, say, 50 per cent or 60 per cent we have had in the last couple of years, then I would say, if we were that fortunate, we would not mind, perhaps, paying a little more taxes.

The Chairman: In effect, then, when you are permitted to carry forward on your earned depletion, it has some of the marks of a tax holiday because, by carrying it forward, when you get into money it reduces the amount that is subject to the tax.

Mr. Lyall: That is correct, but I will say, on the other hand, that it had been earned.

The Chairman: I was not criticizing that, but I am trying to determine a certain point of view. What does the person who puts up risk capital think about, or what does he expect in the way of incentives? And is your proposal even an attractive incentive to get risk capital? You have been assuming that the company has money and can get money and, therefore, will do this, but I am assuming that you may have to find money.

Mr. Lyall: I can only answer that by saying that with certain provisions, and I stress them, we have felt that our proposal would provide an adequate incentive. It is implicit in that that we would be able to attract capital.

The Chairman: In effect, what you are saying is that you have taken the present situation and, by a different formula, have achieved the same result. Therefore in effect what you must be saying is that the present situation is inadequate.

M. Lyall: Subject to the removal of the anomalies that are in the present system.

The Chairman: Yes, one being the carry-forward.

Mr. Lyall: Right.

The Chairman: And extending what should be included in write-offs?

Mr. Lyall: Right.

Mr. McAfee: And recognizing, Mr. Chairman, that the present system in effect penalizes a company for doing what the system is designed to encourage.

The Chairman: Will you illustrate that, please?

Mr. McAfee: Basically as a company explores more and spends more money on exploration the amount of depletion that it gets is reduced. Therefore, if depletion is intended to encourage exploration by virtue of the way the present setup works, it defeats itself.

Mr. Lyall: The more we spend the less we get in the long run.

The Chairman: I have always felt that it is a misnomer to term it depletion if I have to go out and earn it by spending money. The United States looks at it that way in their tax law. They still say depletion is to take care of wastage.

Mr. McAfee: That is correct. What you are referring to, Mr. Chairman, is a pretty important philosophical point. I think there can be several different points of view on it.

As I understand it, the philosophy adopted by the White Paper proposals or by the Government in setting up the White Paper proposals, would endeavour to more clearly confirm that one of the objectives of depletion anyway, and maybe the primary one, is to encourage additional exploration, and by tying it to the amount of exploration done rather than the reverse, it tends to emphasize that point.

You put your finger on it a minute ago when you said that what we really have endeavoured to do in our proposal is first of all to keep the Canadian arrangement satisfactorily competitive with those of the United States and other countries around the world. Secondly, by another mechanism which would in effect recognize the validity of the basis for the White Paper proposals, we try to arrive at an answer which experience has proved is a reasonably adequate incentive.

The Chairman: So instead of going in one door you go in another, but you meet the same people in each.

Mr. McAfee: That is right, and if they are pretty good people that is not a bad arrangement.

Senator Hays: With what other countries in the world are you competing in the petroleum industry?

Mr. McAfee: How may countries are there in the world?

Senator Hays: I mean as far as price is concerned.

Mr. Shepard: We are referring not to price but to the capital dollars which we need to explore and produce.

Senator Hays: How would this application affect the small independant who wanted to take a farm out on a wildcat proposition?

Mr. Lyall: On the farm-out arrangement he would earn a dollar of allowance for every two dollars of expenditure.

Senator Hays: How would he fare under this arrangement?

Mr. Lyall: This would depend first of all on whether or not he has any income from production.

Senator Hays: But he has none; he is a "wildcatter" and this is real risk capital. He wants to take a flyer. Would we not be squeezing him out of the gamble of getting into the oil business?

Mr Lyall: Under the present system with the limitation to net income and with the requirement that you must have production income before you can take any depletion allowance, he is in that situation.

Senator Hays: I know, but I am speaking of the application that you have suggested, not the present system.

Mr. McAfee: He would be no better off under our suggestion than he would be under the present arrangements.

Senator Hays: He would be worse off than today?

Mr. McAfee: No.

Senator Hays: On the one to two basis?

Mr. Cochrane: On the one to two basis at least he has a carry-forward building up for him. Today he has nothing, because he earned no income that year and at the end of five years he still has nothing. So, if anything, he is a little better off under the proposals of Gulf Oil Canada Limited than under the present system.

The Chairman: You are much better off with the loss carry-forward unless in some way you are going to earn income. The wildcatter starts at scratch, and all he has at that stage is an attraction depending on the incentives that would apply if he is successful in finding oil. You would agree, would you not, that the present incentives have proven attractive for a wildcat operation.

Mr. Lyall: There has been certainly a high level of exploration activity in Canada.

The Chairman: Do you think that what you propose, if it were all put into effect and substituted for what we have, would still be sufficient incentive for a person who is wildcatting to be able to get some money?

Mr. McAfee: Yes.

Mr. Lyall: We are saying that, becuase he has to the extent that he has been able to carry on wildcatting up to the present time.

Senator Hays: No, he has never wildcatted.

The Chairman: No, the new rule says he is going to do some wildcatting. Is there as much attraction in the incentives on your basis as now exists?

M. Lyall: The most effective and efficient incentive that you can have, at least from the standpoint of the cost to the Government, is one that is only available if the result of the effort produces revenue which attracts cash.

The Chairman: I am not looking at that end of it, but at the end where you want to develop an industry and have people carry out exploration and development. Therefore it is not a case of what the attraction is going to be when you have finished the job and proven it up. They do not have any particular crystal ball and the White Paper says you need incentive and special rules. How much do you need in that way, and is what you offer now enough?

Mr. Lyall: In that context the only kind of incentive that I can think of if the wildcatter has no income at the present time is a direct subsidy.

Senator Hays: You do not have to give him a subsidy; he has the money and is going to wildcat and take the chance.

Mr. McAfee: The short answer would be the more incentive, the more attractive it is. What you are struggling for, as we all are, is how much is enough?

Again I would suggest that we must best draw on past experience. What we are proposing gets us about to where we are today. Experience would indicate that where we are today has been reasonably adequate to attract enough risk capital and all the rest of it to do a pretty good job so far of developing Canada's oil and gas resources.

This is not to say that this is going to be adequate for ever. As Mr. Lyall pointed out in his comments, with a long dry spell it is going to be much harder to entice people to invest their money if they do not have a very great chance of success. Of course, the converse is true. It will also continue to be a function of what the competition circumstances are around the world, under what circumstances people can invest their money in other areas around the world in relation to Canada.

The Chairman: This raises the obvious question, why make a change in the rules if the change is dictated simply by a desire to match up in some new fashion what you enjoy under the present rule.

Mr. McAfee: We are not proposing a change of rules, Mr. Chairman.

The Chairman: I understood Mr. Lyall to say that the White Paper proposal on earned depletion was acceptable if it had your own addition which you wanted to make, that is \$1 for \$2 instead of \$1 for \$3 and the 20 per cent depletion. That produces quite a different kind of animal does it not?

Mr. Lyall: It does. It removes some of the objectionable features of the present system. Perhaps I might say as well that one of the attractions to us on the concept of earned depletion is that it really recognizes that this is something that is earned. When we go back to the time of the Carter Report the industry was quite concerned about what was referred to as concessions to the industries, and we did not like that term at all. Perhaps it is only semantics, but it implied some special saving to the industry. We think the proper term to use is "an incentive for the industry".

I think the nature of exploration and development is something that is not well understood by the public generally. That is, the concept of allowance which has been earned by a company pursuing an activity. This is the Government's policy for encouraging a company. It might help to have a better understanding on the part of the public of the necessity for this kind of incentive if we are going to develop oil and gas reserves in Canada in the way we think they ought to be developed.

The Chairman: We are really into the question of what are the reasonable and adequate incentives, because there is full agreement that there must be incentives.

Mr. Lyall: Yes sir.

The Chairman: I think maybe we have stretched this around and this might be a good time for Mr. Gilmour to say a few words.

Mr. Gilmour: Gentlemen, our present oil depletion system is something that in practice is very difficult to the mining company, as we were talking about this morning. Our oil depletion system today puts all its emphasis on having production income. If you are an oil company and have exploration and development credit then, of course, these credits must be applied

against the first dollar of production income that you get. There is no such thing as a three-year holiday. Your accumulated exploration expense is saved, and then you apply it against your first dollar of production income—and "production income" I mean your oil revenues minus your lifting costs and any other costs. Consequently, if you have an oil company that is carrying on a continuing program of seeking out new areas for drilling then you will first have to apply your exploration expenses, but this is a continuing expense against your production income. It is only when you have used up all of your credits that you start to benefit by depletion.

The history of a great many Canadian oil companies—the cost of quotas and other things—has been one of relatively very little income coming in to them. Of course, they have continued to explore and prove up other reserves with the result that the majority of our Canadian oil companies have never really claimed a penny of depletion because they do not have that production income after their expenses.

We have in Canada two types of income in an oil company that are taxable. We have what you refer to, Senator Hays, as the wildcatter. I think traditionally in Canada the wildcatter has done his drilling and has raised his capital somehow, either by farmouts or any other way that is open to him. He has done his exploration and, of course, having no production income his accumulated exploration credits were of no use to him. If he is lucky enough to find a proven acreage traditionally he tries to sell that off, say, to companies like our friends here. If he succeeds every dollar of proceeds that the wildcatter gets is income to him. It is not production income, but it is taxable income. Against that taxable income he applies his accumulated drilling credits. If he is lucky he breaks even, and goes home with all of his proceeds. That man, not having production income, never gets a depletion. Instead, he just takes a chance on getting capital proceeds that are in fact taxable.

Our present tax law does not really give any particular incentive to the wildcatter. Mind you, the cost to the major oil company that perhaps buys out those proven fields is regarded as an exploration expense, yet it is able to write off this exploration expense against other income.

Under the White Paper they propose to do away with depletion as we know it, and as it applies today to production income. Instead, the wildcatter or the major oil company who goes out and explores, for every $3 he spends on exploration he gets another $1 as so-called earned depletion, but in point of fact, it is just additional exploration expense that he gets. If the wildcatter who does not care about production income is able to continue to sell, and then he will have $4 of exploration credits that he can use. The major oil company, having paid, say, $3 for the proven acreage, holds that as deductible against its future production income, or any other income it has. The major company would not get the extra $1 because it has not done exploration work, but just made a purchase. It has not earned it in that sense. It is going to mean in practice that your wildcatter will still continue to explore. If he is unlucky, of course, he loses his shirt and there is no tax relief to him. If he is lucky he probably sells off to somebody else and he ends up with enough exploration expense—that is, $4 worth—but perhaps he does not pay any tax on the proceeds.

Senator Hays: Is this a capital gain?

Mr. Gilmour: No, the exploration expense is a reduction. The proceeds since 1960 have been income. Whether you are a wildcatter or a major company, if you are doing a farm-out in the sense of selling your production to a third party along the lines of the United States A.B.C. scheme, the fraction of your production that you sell off is considered to be an income receipt. It is not production income, so you do not get any depletion on it, but you do get the offset.

The Chairman: If he realizes enough on the sell-out to a major company, he gets reimbursed at least what he expended, and he gets the extra dollar.

Mr. Gilmour: Yes.

The Chairman: And anything more he may be able to coax out of the major company.

Mr. Gilmour: Yes, and you pay tax on all of it but he has a deduction of what he spent, $3, plus this so-called earned allowance of one dollar. So the day of reckoning is going to come for what I call the majors, as traditionally so far our majors have proven additional reserves either by purchase, or I guess more frequently by their own explorations.

The Chairman: Mr. Gilmour, you made a statement there, "Of course he pays tax". The wildcatter spends $3 on exploration. He gets a dollar as a bonus. He has $4 that he can deduct from anything that may be income arising out of his dealing with that property. The only place where income tax might come into it is if he gets more than $4.

Mr. Gilmour: I should say, "If he coaxes something out of the major".

Senator Hays: What about selling the proven reserves—how is that treated?

Mr. Gilmour: Every penny he gets for the proven reserve is income to him, and if he can sell his proven acreage for more than his $4—that would be $3 out of pocket for exploration and $1 bonus—then anything over and above that that the wildcatter gets is subject to 50 per cent income tax. Now, so far as the major is concerned . . .

Senator Connolly (Ottawa West): 50 per cent automatically, because he is that class of wildcatter?

The Chairman: It is the corporate rate, Senator Connolly, that he pays.

Mr. Gilmour: If he was paying as an individual, he would be crucified on the personal rates, ordinarily, because of the limited liability he incurs. But the day of reckoning is going to come to all the Canadian oil industry. At the moment, if they have production income in excess of their exploration credits, and they get depletion allowance of 33 1/3, and that depletion allowance could continue throughout the life of the field, or another field, if they had it.

As it is pointed out, this depletion allowance, while it is supposed to encourage additional exploration, actually inhibits it, because the more money you spend on exploration in a large company, the less depletion it contains that you can claim, because depletion is based on production income, minus your exploration credits that are available to you. If you are doing a lot of exploration, then the credits will offset your production income, and you pay no tax, but you get no depletion. Our present depletion is not something you can defer or save—you get it, or you forfeit it, each year.

Under the proposal in the White Paper, if our friends here today were to spend their own money on exploration, as they have been doing for many years, then they will have a deduction of the money they spend and, calling that $3, they will add another dollar of exploration credits.

When the day comes when we have no limits or quotas on our oil, these gentlemen are very quickly going to run out of their exploration credits, including the extra dollar.

Under the present system they would undoubtedly do further exploration in a separate company so that they continue to get the depletion on existing properties. They were able to do that up to about the end of 1969 and then a watchful tax department said, "You have to group it all together and, in effect, the more exploration you do the less continuing profit depletion you will get." So our present system cut a hole, in fact, in it last year by regulation, and today our profits depletion inhibits exploration, and now the new system is simply going to say, "You are going to get a bonus of one-third of your exploration expenses, but no depletion, so that once you start coming into good production, because you are able to take oil out of these various places, which you cannot at this moment, then you are very quickly going to run into taxable income."

The Chairman: At the full rate.

Mr. Gilmour: Yes, at the full 50 per cent rate. Consequently, our present depletion system is no good to the wildcatter. It is of no use to the large corporation that is ploughing back on additional depletion. So it only applies, I guess, to what you would call the mature company whose production income exceeds these exploration expenditures. And while it has worked fairly well on mining companies, as we saw this morning, it does not work too well for the oil companies—and I think the White Paper is going to work an awful lot less well.

Senator Hays: How is the wildcatter treated in the United States?

Mr. Gilmour: I do not know, Senator Hays. I can find out for you. I cannot hazard an answer.

The Chairman: We will find out. We will make a study of it.

Now, that we have had that clarification, is there anything in it in respect to which you might hold a differend view?

Mr. Lyall: No, sir, that is an admirable statement.

The Chairman: Well, it looks as though we have done what the depletion allowance is intended to do—in other words, we have depleted that particular subject.

We move now into another point. First of all, I interrupted you on one point. Do you want to continue?

Mr. Lyall: What we think are the advantages of our own proposal in this area as compared with the White Paper proposals are stated in page 16 of our submission, and I should like to review them quickly.

First of all, the proposal eliminates anomaly and inefficiency inherent in a net income limitation.

Secondly, it is simple and easy to administer. Thirdly, it is directly related to the level of activity for which it provides an incentive. Fourthly, for taxpayers continuing an active exploration and development program,—and we expect to be one—the allowance which would be earned under Gulf Canada's proposal would not be greatly different from the allowance under the present system or from the allowance proposed in the White Paper except for unreasonable limitations in these latter systems. Fifhtly, the limitation to 20 per cent of gross income is competitive with the United States percentage depletion allowance, although the further limitation proposed of $1 of allowance for each $2 of eligible expenditures will generally be much more restrictive than the limitation to 50 per cent of net income under the United States system.

Then, finally, I should just like to mention the point in the White Paper concerned with depletion allowance to non-operators, which are mainly the holders of royalties. As stated on page 18 of our submission, the proposal in the White Paper to discontinue the depletion allowance of 25 per cent to non-operators in our view has a retroactive effect, and we recommend that the present allowance should be continued to apply to income received from royalties which were held when legislation discontinuing the allowance becomes effective or, at least, for a minimum transition period of five years.

The second main area on which I should like to add to the remarks already made by Mr. McAfee is the integration of corporate income and personal income of shareholders. Section 4.18 of the White Paper sets out what are considered to be the shortcomings of the present tax structure as it relates to the taxation of corporate income and the personal income of shareholders. These stated shortcomings appear to be mainly concerned with, first, the so-called delay in collection of personal tax from shareholders on the undistributed income of corporations, and especially smally closely-held corporations, which has been subject to tax at the lower rate of 21 per cent on the first $35,000 of income; and, second, the possibility that the dividend tax credit available under the present system may confer a greater advantage on one shareholder than on another and may be available where the corporation paying the dividend has not already paid sufficient tax to the Government to cover it.

To remedy these stated shortcomings the White Paper proposes what on the surface appears to be a very neat and ingenious method of integrating corporate income and personal income of shareholders, but on closer examination proves to be extremely complex from an administrative standpoint and could lead to inequities in the tax structure that in our view are no less serious than any which may exist under the present system.

Again, as explicitly stated in Section 4.29, the White Paper proposal for integration is in essence to create one set of rules for the closely-held corporation and another set of rules for the widely-held corporation. It appears to us that several of the proposals in the White Paper have been designed as integral parts of one over-all system which has as its main objective the elimination of what are considered to be the shortcomings of the present system enumerated in Section 4.18.

The Chairman: When I analyse those shortcomings so-called, there is one that presents difficulty to me, and that is to assume that the taxes on profits in the corporation are payable in two instalments—one being the corporate instalment and the other being the taxes that become payable by the shareholder when he receives the dividend. That seems to be part of the corporate taxation system. That is an extraordinary concept. If there are no dividends, then the corporate rate is 50 per cent; but if there are dividends the corporate rate with the company is still 50 per cent. It cannot be any more. How they can then get the concept that what goes to the shareholder is the second instalment of income tax that is due when the corporation makes a profit is beyond me.

Mr. Lyall: I think it is very important that these so-called shortcomings, as you put it, should be examined very closely, and we propose to do just that.

The Chairman: All right.

Mr. Lyall: I should like to review the proposals that again appear to us to be integral parts of this one over-all system or package, if you like, and these include, first of all, the removal of the present low rate of tax of 21 per cent on the first $35,000 of corporate income; second, the proposed distinction between closely-held and widely-held corporations and the different tax treatment to be accorded to each group; third, the right of election by a closely-held corporation under certain specified conditions to be taxed as a partnership; fourth, the proposed gross-up and credit system for shareholders on dividend income and the related proposal which would permit tax paid by a corporation to be creditable against shareholders' income only if it is passed through to the shareholders within two and a half years from the end of the taxation year in respect of which it was paid—the so-called "stale-dating" of creditable tax; fifth, the proposed treatment of capital gains and losses on the

sale of shares of companies and, in particular, the different treatment to be accorded capital gains or losses on sale of shares of closely-held and widely-held corporations; and, finally, the proposed revaluation of shares of widely-held corporations to market value every five years and the "deemed" realization of gains or losses on such revaluation.

We are concerned that some of these proposals may be considered so essential to achieving an over-all balance and mathematical precision in the proposed system that there may be a reluctance to change them—any of them—because any change at all might create an imbalance which would destroy the theoretical symmetry of the system.

In the first place we are by no means convinced that the stated shortcomings of the present system are as serious as the White Paper would imply, or that they give rise to inequities which could not be corrected by less drastic measures than the White Paper proposals. In our opinion these proposals, taken together, amount to a virtual scrapping of our present system in favour of an untried system which, in its present form, would certainly create major administrative problems and lead to certain inequities which are discussed in some detail on pages 21 to 30 of our submission.

We suggest, and I think this is your point, Senator Hayden, that it would be advisable to consider each of the White Paper proposals included in this package on its own merits in relation to what are considered to be the shortcomings of the present system, rather than as an integral part of a complete, new system designed as an over-all solution for a number of problem areas in the tax structure.

First of all we have the removal of the low rate of 21 per cent on the first $35,000 of corporate income. I think it is clear here that the problem is really a question of taxation of small incorporated businesses. The principle set out in Section 4.20 does not seem to be unreasonable, namely, that the tax on income earned by a small business should be the same whether it is carried on as an individual proprietorship or partnership, or through an incorporated company.

The Chairman: I think maybe it means a little more than that, doesn't it? Doesn't it also mean that a company, a small business company, one that is incorporated, can elect either to pay the corporate rate or to be taxed on the partnership basis, and that means on the marginal rates of those who have share interest in the company?

Mr. Lyall: As I say, this principle does not seem unreasonable, and therefore we have agreed with the proposal that under certain specified conditions a corporation should have the right to elect to be taxed as a partnership.

We have also said on page 39 of our submission that we agree with the proposal of a single tax rate for corporations but only if there were other relieving provisions which could allow retention of funds to promote growth because of the limited access small companies normally have to outside financing.

The Chairman: Would you mind stopping right there for a moment, Mr. Lyall. We have had lots of discussion concerning small businesses. It seems that the difficulty that may have provoked this course of treatment proposed in the White Paper was that the low rate on the first $35,000 was extended to all corporations. This was a misnomer that was used when it was introduced in the first place. It was termed a relief for small businesses and given to every company. Your company, I take it, is not affected at all if you do not get the benefit of the 21 per cent on the first $35,000.

Mr. Lyall: On a consolidated basis we would pay about $10,000 more tax.

The Chairman: But for the small business to get the benefit of the lower rate they conceivably could have as much as $8,000 or $10,000 more a year in retained earnings at the lower rate. That would be something very substantial in the way of attracting credit. So if small businesses were put in a separate category and properly defined by some limitation on net profits, or maybe net profits and capital, can you see any objection to that?

Mr. Lyall: I would like to say in this area, sir, that we really do not consider ourselves to be authorities on the question of taxation of small businesses.

The Chairman: No, but you have expressed a view that there should be one rate of tax so, having expressed that view, I want to hear what you think?

M. Lyall: What we are really trying to say is that the tax system should not deprive small business of funds required for growth and expansion, but surely there must be a better way to accomplish this result than the dual rate of tax applicable to all corporations under the present structure.

Senator Hays: Are you speaking for your sales outlets, service stations and bulk holders?

Mr. Lyall: Many of our independent dealers are incorporated companies and subject to this.

Senator Hays: Would these people be in trouble? I know they are in Saskatchewan, but as a whole would this hinder their progress, or how would it affect them to your knowledge? You must have many, many outlets and you have a great interest in small business.

Mr. Lyall: I think the result would be that certainly as far as the corporation is concerned it would greatly, within the context of the small business, increase the tax burden on the small incorporated company.

However, we must consider how the integration proposals would affect those. This would depend to a great degree on the personal income situation of the owner of the small business.

Senator Hays: Would this affect you P and L account by a reduction in losses and that sort of thing?

Mr. Lyall: I doubt very much whether the proposals relating to the taxation of small businesses would have very much direct affect on our company. It might affect the viability of some of the smaller dealers who market our products. Many of those, of course, are lessees from the company and are carried on as proprietorships or partnerships rather than through the form of incorporated companies.

I do not think there is likely to be serious impact to Gulf Canada directly in this area, but we are concerned about the principles involved.

Senator Hays: You have such great concern because of your sales outlets?

Mr. Lyall: That is right, but the system proposed here, which seems to us to be directed mainly to the problem of taxation of small businesses flows over. It does have an impact on a widely-held company such as our own and the taxation of shareholders on dividends received from our company.

The Chairman: It may be more generous in relation to closely-held corporations because of the conclusion that included in that prescription would be small businesses.

Mr. Lyall: It could in certain circumstances.

The Chairman: If you kept to the one rate basis of corporate taxation in relation to small business, once you define what is a small business, whether they are subject to the 50 per cent rate but only 21 per cent is payable forthwith and the difference between 21 per cent and 50 per cent, that rate would apply when the money was paid out.

Mr. Lyall: That may be the solution. We have suggested in our submission that there really seems to be a better way of doing this than the dual rate. We have suggested that it might be done by accelerated capital cost allowances where you have a small business that requires fairly heavy capital investment in plant and equipment, or by deferral or taxes. However, we have not made a thorough study in depth of the problem of the small businesses. There may be more effective ways of dealing with it than the suggestions we have made.

We think this whole area should be re-examined carefully before the system that has been designed to meet the stated shortcomings is incorporated into the law.

The Chairman: We should find an answer; there is a problem and we know what it is.

Mr. Lyall: Yes. Secondly, the proposed distinction between closely-held and widely-held corporations. We simply do not agree that this is a valid distinction. This has been discussed many times before and I do not think it is necessary to go into it again. We also do not agree that it is a sound approach to the problem of taxation of small businesses.

It follows that we do not agree with the different treatment to be accorded to closely-held and widely-held corporations under the White Paper proposals, either on taxation of dividends or capital gains, or losses on sale of shares in these companies.

Thirdly, on the proposed gross-up and credit system, we are not convinced that the present tax credit system results in any serious inequities, unless any deviation from absolute mathematical position is regarded as an inequity. We therefore recommend retention of the present tax credit for dividends with an increase in credit to 25 per cent to achieve closer integration, or a variable tax credit which would be higher in the lower income brackets to achieve virtually the same result as the gross-up and credit system proposed in the White Paper.

The Chairman: In arriving at the variable rate, would you do it on the basis of taking an average of the income tax paid by the person, or the top rate?

Mr. Lyall: It is set out on page 24 of our brief, sir. It is really in relation to the taxable income, the marginal rate of the individual.

The Chairman: Well, marginal rate means the top rate.

Mr. Lyall: That is right. The next main area of concern touched on by Mr. McAfee was the question of the proposed treatment of capital gains. I reiterate and emphasize very strongly the need for a cautious approach if we are going to move into this area, rather than going overboard to the extent that we feel the White Paper proposal does. Accordingly we have recommended that not more than 50 per cent of a realized gain or loss should be taken into income, and that the rate of tax applicable to 50 per cent of the realized gain should not exceed 50 per cent. In other words, that the maximum effective rate of tax on any capital gain or deduction for any taxable loss should not exceed 25 per cent.

Until there is some assessment of the impact this may have on the economy or investment climate in Canada, it would be preferable that the percentage of the gain brought into income should not exceed 25 per cent. A rate of tax not in excess of 50 per cent should be applied, for a maximum effective rate of 12-1/2 per cent.

Senator Hays: What benefits has your company received from capital gains over the last five or six years?

Mr. Lyall: We received one very major benefit in 1966. In that year we sold the shares of a wholly-owned producing subsidiary company we had owned in the United States for many years and realized a substantial capital gains on that.

Senator Hays: I am wondering why you condone the capital gains tax at all. What is your reasoning and why do you say 25 per cent? What benefits or how fertile is the field in Canada for people coming here because we have no capital gains tax?

Mr. Lyall: I do not think there is any question that at the present time it is an incentive to capital investment in Canada because we do not have capital gains tax.

Senator Hays: That is one of the real incentives?

Mr. Lyall: Yes sir. I guess in saying that we go along with the gradual capital gains tax we are really saying that Canada is about the only major country that does not have this as part of this tax base.

Senator Hays: You do not really have a reason?

Mr. Lyall: We would much prefer or I would much prefer, personally, that there should not be a personal capital gains tax.

Senator Hays: Previously I used a kind of a vulgar expression. It is like saying thou shalt not commit adultery, but if you do, this is the way to do it. Many briefs we have received said that this is inevitable. You really have no foundations for saying that.

The Chairman: I suppose the only one you could put forward would be that if you need more tax revenues and you feel that the other sources have been taxed at pretty high rates this is a non-tax source that is recognized as the source elsewhere in the world so we should get into line.

Senator Hays: Other than the fact that the very people who are going to be paying most of the capital gains tax are also the people we are taxing in that bracket between \$15,000 and \$25,000. This is the only benefits they had, even though their counterparts in the United States pay more income tax.

The Chairman: It might be between \$15,000 and \$40,000.

Senator Hays: They do not realize. They look at Senator Aseltine and see that he sold his farm for a million dollars and they want to get him, but do not think of what is going to happen to them when it comes a reality.

Mr. Lyall: They think the only basis we could justify the capital gains tax is what Senator Hayden said, for broadening the base of income and whether or not earned income has just about reached the saturation point and you have to look to other areas for revenue.

The Chairman: It is a misnomer to call it capital gains. They should have a separate category, the taxation of capital gains.

Senator Everett: You have put upper limits on the taxation of capital gains, but it seems to me you have left them in the income sections of the act. You have not excluded them from the income sections as the Americans do, therefore, I think that it is germane to ask you what you would do about the deductibility of capital losses, taking into account the fact that if they are part of income your gain is at a high marginal rate and your loss is at a low marginal rate.

Mr. Lyall: We have not made a specific recommendation on that point. I think that would be an inequity in the proposed system that should be taxed at a high marginal rate and not have the same deductibility of losses.

Senator Everett: You agree that is what would happen under the provisions of the White Paper.

Mr. Lyall: I think under certain circumstances, yes.

Senator Everett: Do you think then that is an argument for removing the capital gains tax from the income tax provisions, as I believe the Americans do.

The Chairman: And have a fixed rate.

Mr. Lyall: They deal with it entirely separately and apart from income from other sources.

The Chairman: That is correct.

Mr. Lyall: In that event, of course, you could be faced with the situation where your capital losses might exceed your capital gains and you would not be able to deduct them from other income.

Senator Everett: The same thing could be true when it is part of income.

You make the point which seems to me to be very important, if you use your system. That is Item E on page 34.

Mr. Lyall: I was just going to make a comment on that. Certainly, if a capital gains tax is introduced then in our view the averaging provisions proposed in the White Paper are quite inadequate and unnecessarily complex. It particularly goes against the grain as far as I am concerned when they suggest that they do not have to worry about this, that the computer will work it out for you.

The Chairman: You would support the present law in section 36 of the Income Tax Act, would you? That is the averaging there.

Mr. Lyall: This relates to long supplement payments. I think that would be much fairer, sir.

Mr. Cochrane: It probably should be extended more than the three year period for, say, five years.

The Chairman: The person who gets hurt by the new rule is the person who has the small sudden burst of income, because he does not qualify or enough to qualify him for averaging.

Mr. Lyall: The person who has the $18,000 level or above has no benefits from the averaging provision at all.

Mr. Cochrane: This in part answers the senator's question on the rates. At least, if you have liberal averaging provisions you tend to up your rate structure—not the ones proposed in the White Paper.

Senator Everett: Could you read Item (e) on page 34 into the report?

Mr. Lyall: It is:

> (e) That a more liberal system of income averaging be allowed, possibly on lines recommended by the Royal Commission on Taxation. The White Paper proposals are minimal and should be expanded to be of any real value.

The final point in relation to capital gains that I would like to make a comment on is in regard to this five-year revaluation and deemed gains or losses of the revaluation basis.

The Chairman: That has been raised many times.

Mr. Lyall: In our opinion it is extremely difficult to see what the implications of this proposal will be.

Gentlemen, there are a number of other proposals in our submission which are more or less self-explanatory. We do not propose to comment specifically, but we are glad to answer any questions which you may have.

The Chairman: I read into the record this morning when the question was raised about the extent of the application of capital gains to personal property and with the limitation that anything abouve $500 should be subject to capital gains. And with the limitation that anything above $500 should be subject to capital gains and deemed to be realization provisions applying to it. This was a letter which was written by Mr. Ben Ward-Price in Toronto, who is recognized as being thoroughly experienced in this field. He was consulted by the Department of Finance on this question, and he told them that it was impracticable at $500, that there would not be enough people in Canada to be able to do the values or get them done within a reasonable time. He suggested that if you must have it, you should make it a least $5,000, because then it would be likely to include only the things that were likely to appreciate in any amount, like fine silver and certain types of paintings. You have not any particular corporate interest in this, I take it.

M. Lyall: That is correct.

The Chairman: If there are no other questions, we want to thank you very much, Mr. McAfee.

Mr. McAfee: Thank you, Mr. Chairman.

Senator Everett: I have one last question. There is one point which I have never seen in a brief

before, and I would like to get an explanation. It is the point that the White Paper proposes partial retroactive taxation of pre-existing goodwill. Would you care to explain how the White Paper does this?

Mr. Lyall: Mr. Cochrane can speak to it better than I can.

Mr. Cochrane: Goodwill, in the way it is set up in the White Paper, is treated so that of any proceeds from the sale in the first year, 40 per cent would be taken into income, regardless of the fact that goodwill has been accumulated in many years in the past and was in existence on valuation day. The idea is that any sales of goodwill after those in the first year would bear 40 per cent and then it goes on progressively, at 5 per cent increment, until you get up to 100 per cent. This in our opinion is completely retroactive taxation. Partly of course it depends on which you are talking about. But in many cases I would believe that the goodwill was created and has been maintained up to the date of the White Paper and the goodwill itself is like land, it is a non-depreciable asset of the company, which should be valued as of valuation day like any other capital.

Senator Everett: Are you saying that, if the underlying assets of the company are worth $1 million, but the shares can be sold for $2 million because of earning power, the $1 million is good will, under the White Paper?

Mr. Cochrane: This would be so, under certain circumstances. Normally, on the sale of shares, you have different rules as to the value of those shares as of the day of the sale. And if it were a closely held corporation that had no market value for the shares, certainly it would be different.

Senator Everett: So in the example, I have given, there would be retroactive taxation on $1 million?

Mr. Cochrane: If you sold it in the first year, it would be 40 per cent, that would be $400,000.

Senator Everett: And in the fifth year it would be a million dollars?

Mr. Cochrane: One million dollars, yes.

Senator Everett: So in this case there is a clearcut case of retroactive taxation?

Mr. Cochrane: Very much so. I was amazed to see that, in spite of the avowed statement in the White Paper that they were trying to avoid retroactivity.

Senator Everett: As Gulf Oil, you are opposed to retroactivity?

Mr. Cochrane: They are opposed to treating goodwill in the way it is suggested in the White Paper, both to including it in amortization and including the proceeds into income at these various specific percentage levels set out.

The Chairman: Do you suggest an alternative?

Mr. Cochrane: We suggest that it be treated like any other asset and it be an asset that is just valued on valuation day for whatever it is worth, and if you sell it for 10 per cent higher a year from now, that 10 per cent be liable for capital gains, like any other asset.

Senator Everett: I think that is a most important point that you have raised; and by doing it in your way, by valuing it on valuation day, there would be no retroactivity.

Mr. Cochrane: That is right.

Senator Hays: I think it was in your brief—if I am wrong you can correct me—you said you did not think that homes should be included. What was your interest in farms? I want to thank you for that. I have an interest there myself.

Senator Aseltine: Land is down now. You cannot give it away. What are we going to value it at on valuation day?

The Chairman: It had better have a high value.

Senator Aseltine: How is the poor man on a farm going to retire? If it goes up in value, as it is sure to do, his tax on the difference between what it was worth on valuation day and what he sells it at when he retires, will be so great that he has nothing left to live on.

Should not farm lands that were not in production be exempted?

Senator Hays: Yes, that is what they suggested. That is what I was asking about.

Mr. Cochrane: This was not of any direct concern to the company.

Senator Hays: Is this apple polishing?

The Chairman: This comes under the heading of equity in taxation.

Mr. Cochrane: We think that a broadening of the tax base will be going too far.

Whereupon the committee adjourned.

APPENDIX "A"

SUBMISSION TO THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

BY

THE ALGOMA STEEL CORPORATION, LIMITED

DOMINION FOUNDRIES AND STEEL, LIMITED

THE STEEL COMPANY OF CANADA, LIMITED

ON

THE GOVERNMENT'S PROPOSALS FOR TAX REFORM

WEDNESDAY, MAY 6, 1970

SUBMISSION ON THE GOVERNMENT WHITE PAPER
entitled
"PROPOSALS FOR TAX REFORM"

The three steel companies presenting this submission account for 80% of Canada's output of iron and steel. They also mine and consume 20% of the iron ore produced in Canada. They have grown rapidly and consistently since the early fifties and have major plans for expansion during the next ten years.

We -- Algoma, Dofasco and Stelco -- are directly concerned about the proposals made in the White Paper on Taxation to reduce drastically the mining incentives as they affect iron ore. Quite naturally, we also have a more general interest in the White Paper since it advocates major changes in the whole tax system which would affect the Canadian steel industry as it would many other businesses and groups.

At this time, however, we wish to draw your urgent attention to the probable consequences for the Canadian steel industry of the proposed sharp curtailment of the mining incentives. There is no doubt that the changes in the mining incentives set out in the White Paper would have a major negative effect on iron ore mining in Canada. Nor is there any question that, through their impact on the costs and earnings of the steel companies, the proposed changes in the mining incentives would significantly weaken the competitive position of the Canadian steel industry and inhibit its expansion in the years ahead.

Such developments would lessen the contribution this basic industry could otherwise make to a stronger Canadian industrial structure in a period of [illegible] economic history when industrial strength should have a very high priority. Indeed, looking to the seventies, it seems quite clear that the development of strong industrial positions, in Canadian hands where possible, is one of the country's most urgent economic requirements.

No Government studies of the impact of the proposed changes in the mining incentives on iron ore mining or on the Canadian steel industry have been made available. It is, therefore, not clear whether the unfavourable economic consequences which would flow from these changes were foreseen by the authors of the White Paper and regarded by them as an acceptable price to pay. We frankly doubt whether the probable consequences were in fact anticipated, since it is difficult indeed to imagine them as being acceptable.

In any case, we have given careful consideration to the position of the Canadian steel industry in relation to the growth of and prospects for the Canadian economy and in relation to external competitive factors with respect to both iron ore and steel. An attempt has been made to assess the influence of the mining incentives on the past successful record of the industry, to appraise some of the relevant factors in the outlook for the seventies and judge the likely effects of the proposed changes in the tax incentives. We have reached the following conclusions which will be developed in the remainder of this Brief.

Conclusions

1. The mining incentives have been an effective part of Canadian economic policy as they have affected iron ore mining and the Canadian steel industry. This has had a strongly favourable impact on the entire Canadian economy.

    (a) They have resulted in substantial iron ore developments that would not otherwise have been undertaken in Canada and in this way have contributed healthy growth in areas where there were few other possibilities of economic activity.

    (b) By keeping down the effective cost of iron ore, they have helped make the industry more competitive and thus have promoted its growth and efficiency.

(c) The growth and efficiency of the Canadian steel industry has made steel less expensive relative to supplies from the United States, and more readily available to Canadian users, thus promoting soundly-based industrial development in Canada.

(d) The expansion of the steel industry has had a major beneficial effect on Canadian producers of machinery and equipment.

(e) Because of its replacement of imports of steel and iron ore and because of its development of steel exports, the above average growth of the steel industry has resulted in savings of foreign exchange presently amounting to a good $300 million per annum.

(f) The industry's ability, aided by the mining incentives, to generate internally much of the money needed for expansion has helped it to remain Canadian-owned and controlled.

2. The seventies are going to present a real challenge to the Canadian steel industry even without adverse changes in tax laws.

(a) Iron ore is abundant in the world, and even under favourable circumstances, Canadian ore will face substantially increased competition. This will continue to work to reduce costs of foreign steelmakers relative to the costs of Canadian producers.

(b) Off-shore competition in the Canadian steel market will probably increase.

(c) Outside money will be harder and more expensive to raise in the seventies than in the sixties.

(d) To merely maintain its position, the Canadian steel industry will have to invest very large amounts and take considerable risks; to serve the prospective Canadian market in 1980 adequately and efficiently, the industry will have to invest a minimum of $3 billion in new capital facilities even assuming no further inflation.

3. In these circumstances, adoption of the White Paper proposals with regard to the mining incentives would seriously curtail the growth and efficiency of a Canadian industry essential to the healthy development of the industrial economy.

   (a) It would adversely affect the economics of projects for iron ore development in Canada and eventually lead to larger imports of ore and less development in poorer regions of this country.

   (b) It would significantly raise the cost of making steel in Canada which would have the double adverse effect of reducing the industry's internal generation of funds and at the same time of reducing its ability to attract outside funds.

   (c) It would mean that the next round of expansion in the steel industry would be smaller and slower than necessary to keep up to Canadian demand, that steel would have to be imported to satisfy a greater portion of Canadian needs, and tnat prices and availability of steel products to Canadian consumers would be less favourable than would otherwise have been the case.

4. The proposals for integration of corporate and personal income taxes would seriously reduce the effectiveness of the present mining incentives. Since the benefits of the incentives would not be passed on to shareholders through tax credits, the industry's capacity to raise outside capital would be considerably reduced in relation to business generally.

5. Any reduction in capital cost allowances, which the White Paper suggests will be studied later, would further weaken the contribution of the steel industry to healthy economic growth in Canada and, like the proposals for reduction of the mining incentives, would be inappropriate, particularly at this stage of Canada's economic development.

Mining Incentives Affect Entire Integrated Steel Industry

Before giving the reasons for these conclusions, we wish to make it clear that the mining incentives have what might be described as a double effect in their application to the steel industry. They do much more than stimulate the mining of iron ore, important as that is. The steel companies are only looking for raw materials to feed their furnaces, not for minerals to sell. They must get iron ore somewhere and the incentives have been a very effective way of seeing that Canadian rather than imported ore has supplied the great increase in their needs over the past decade. What is equally important is that the incentives have in effect provided lower cost ore, which has improved the earnings and internal generation of funds of the industry and thus stimulated its growth and efficiency from the mine right through to the finished steel product. So, for steel, the present rules have turned out to be a potent force for growth of the whole integrated industry. The value of the incentives should be judged in these terms and not by their benefits to iron ore mining alone.

Under the changes proposed in the White Paper, exploration and development expenditures relating to mining would become the crucial factor in the mining incentives, replacing the tax exemption for new mines and the present system of percentage depletion. For steel companies, exploration outlays represent a relatively small part of the total investment in mining. There is in fact a good deal of ore owned or leased and ready to be developed if the economics justify doing so. The effects of the proposed changes on the steel industry would be to eliminate about three-quarters of the value of the incentives.

The system now in effect has the great merit that it works, and works well. While we are not expert in the oil and gas industry or in mining generally, it is crystal clear that the exploration-oriented system of incentives proposed in the White Paper would have an extremely severe impact on the integrated steel industry

and we question whether such a result is really intended. We emphasize that the proposed system does not make sense for steel and would retard the growth of this key industry.

We now give briefly our reasons for the conclusions presented to you. First, we turn to the steel industry's record which speaks volumes for the effectiveness of the tax incentives. We then consider the effect of the mining incentives on iron ore mining in terms of our own practical experience in recent years, and in terms of the plans for expansion now being considered. This is done against the background of international competition in iron ore. The broad effects of the mining incentives on the integrated steel industry are then reviewed. And finally, we look at the tax incentives against the needs for steel in the seventies and the trends in competition and financing which seem relevant and important.

Canadian Steel in Perspective

There is no question that the Canadian steel industry has been an important dynamic factor in Canada's development during the past fifteen years or more. In 1968, the industry's net sales were approximately $1.4 billion and, with a value added approaching $700 million, it ranked as Canada's third largest manufacturing industry. If consumption of Canadian iron ore is included, the industry was responsible for an estimated additional value added of $90 million annually.

Steel output has been growing more rapidly than that of manufacturing generally -- at about 7 per cent per annum in the past fifteen years compared with 5-1/2 per cent for manufacturing as a whole. The industry employs about 45,000 people directly at relatively high wages, and its substantial purchases of equipment and supplies create employment for many other Canadians.

Since the war it has become a high productivity industry which has succeeded in developing and maintaining a price structure lower than that of the United States steel industry to the benefit of Canadian users. It has displaced imports and developed exports thus making a major contribution to a stronger Canadian balance of payments. Because it has provided a reliable source of supply for a wide range of steel products at competitive and reasonably stable prices, it has contributed significantly to the growth of secondary industry in Canada. The foregoing points are further developed in Appendix A.

Effect of Mining Incentives on Iron Ore Mining

(a) During the Sixties

As at the end of 1969, investment in Canadian iron ore properties by the three companies was $319 million. We have looked at the four largest mines -- the Sherman, Griffith, MacLeod and Wabush -- which the three companies have developed or have had a part in developing during the sixties. We have taken the actual results to date and projected results for the estimated lives of the mines to determine the expected rates of return under the existing tax system. Those rates of return have then been recalculated on the assumption that the proposals with respect to mining incentives in the White Paper had been in effect from the beginning in each case. The difference is major in all cases and the proposals would have cut the average rate of return on investment by almost one half.

A reduction of this magnitude in the rate of return has serious implications. It would have removed the inducement offered to Canadian steel companies to develop their own iron ore mines in Canada. It is doubtful if any of these developments would have gone ahead if the White Paper proposals had been in effect.

These are all important mines which have contributed to development in northern Ontario and Quebec-Labrador at a time when demands of United States consumers for additional Canadian iron ore have been becoming less insistent. They have contributed to soundly-based regional growth in some of the undeveloped parts of Canada where there were few other potentialities for development. The mining incentives are by far the most important of the policies that have worked effectively to bring about better regional balance. They have frequently brought development where no other alternative for healthy growth existed and have helped areas which urgently needed additional sources of support. They are the essence of a northern development policy since in most cases mining or extraction of oil are the only economic bases for growth.

(b) The Seventies - Effect on New Mining Projects

Applying the same approach to new iron ore mines the three companies are considering, projections indicate that the effect of the White Paper proposals would be to reduce the potential average rate of return by more than 40 per cent.

Two of the companies have to decide soon whether or not to expand the Wabush operations. Because this is an expansion of an existing mine rather than a new mine, the effect of the White Paper would be slightly less severe although it would still mean a substantial decline in the rate of return. The United States partners in Wabush are doubtful about participating in this expansion and concerned at the possibility implied in the White Paper of a sharp cut in the rate of return on their earlier investment. There are alternative opportunities for expansion of iron ore supplies elsewhere. For the Canadian companies in the project, the Wabush expansion could be a very important source of the additional ore they will need in the seventies. And although a Canadian development would be preferable, this does not mean that the companies can ignore costs or fail to arrange for the most economical sources of supply. They must do everything they can to remain competitive.

Other important projects under consideration are large low-grade deposits in northern Ontario -- developments which again call for high capital investment and a fairly long payback. Costs are high and projections are subject to a wide margin of error. The degree of risks would be considerable and the amounts at risk large. The Canadian steel industry must constantly reassess its sources of raw materials and the companies prefer to get their ore in Canada. But they have to compete and if iron ore can be obtained elsewhere at lower cost they cannot afford to weaken their competitive position. It is a fact that similar iron ores can be obtained from or developed in the United States. While transportation costs of overseas ores would be higher for inland steel producers, the quality and prices of available supplies could eventually make them attractive to Canadian mills. There is an abundance of iron ore in the world, foreign supplies are becoming increasingly available and it costs a great deal of money to develop remote Canadian properties. The White Paper proposals would take the emphasis off Canadian developments and place it on foreign alternatives.

Iron ore is a common mineral and Canada has no special advantages in its production apart from relative nearness to the large North American steel industry. Moreover, the Canadian position today with respect to iron ore is relatively weaker than it was say ten years ago. Over the decade, there have been enormous discoveries in Australia, Latin America and Africa and a veritable revolution in the transportation and handling of ore, including the use of giant ocean carriers. The cost of ore has declined for the seaboard steel industries like those of Japan and some in western Europe and this trend may be expected to continue. Buyers of Canadian iron ore have more and better alternatives than they had before, and competitors of the Canadian steel industry now have access to lower cost ore supplies.

Thus, international competition in iron ore and, through the cost of ore, in steel has shifted against Canada to some extent. The drastic cut in the mining incentives proposed in the White Paper would sharply accentuate this

unfavourable trend.

A statement concerning the international picture in iron ore is given in Appendix B.

Effect of Mining Incentives on the Integrated Steel Industry

There is no doubt that the existing mining incentives have contributed in an important degree to the healthy state and good performance of the Canadian steel industry in recent years. In addition to promoting the mining and processing of iron ore in Canada, the incentives have resulted in lowering the effective cost of iron ore which has helped the industry to generate the earnings and internal funds which have been the key to the industry's efficiency. Without the mining incentives the growth of the industry would have been more difficult and more expensive and probably significantly less than in fact it has been.

We should like to emphasize that the application of tax incentives to the steel industry has not been at the expense of other Canadian taxpayers. In the first place, these incentives only apply if the industry earns profits. The incentives have not supported weak positions but, on the contrary, have encouraged developing strength. By stimulating development of a strong and efficient steel industry, they have broadened the corporate tax base not only in steel but in supporting industries and also in a variety of steel consuming industries. The personal tax base has also been broadened through steadily increasing employment and mounting wage and salary payments.

By stimulating the growth and competitiveness of the steel industry, the incentives have strengthened the economy and, in all probability, have resulted in a substantial net addition to tax revenues. The test is in the record -- how well the steel industry has served the Canadian economy, and, as shown in Appendix A, the record is impressive.

The Need for Incentives in the Seventies

So much for the past. What are needs of the new decade? What are the problems the steel industry will be facing?

To begin with, it is evident that Canada has a great potential for economic growth in the ten years ahead. There will be a very striking increase in the work force -- proportionately greater than in any other advanced country including the United States. The level of education of these many new workers will generally be much higher than in the past and a mounting flow of trained and expectant graduates will be pouring out of our universities. Canada has the basic human foundation for great expansion in the seventies though she will have to generate a high rate of saving -- higher than at present -- if she is to take advantage of her opportunities and make progress in improving the quality of life.

In this environment, demands for steel will continue to expand. We estimate the average annual increase in Canadian steel consumption at about 6 per cent. If the Canadian industry is to maintain its share of the Canadian market, an increase in Canadian raw steel capacity of 9 million tons by 1980 from the present level of 13 million tons would be necessary. At current price levels this additional capacity would involve new investment in plant and equipment by the industry of $3 to $3-1/2 billion. If inflation continues at a moderate rate, the required investment could amount to from $3.5 to $4.0 billion.

These estimates may even be conservative and they easily could be greater even without inflation. The 6 per cent annual increase in steel consumption in Canada is no more than experienced in the last decade. In addition, if the industry is to remain efficient and competitive as it is today, it must push ahead with new processes and new techniques. The strength of the industry reflects the fact that it has been expanding and pioneering in new

processes for years past. Canadian steel companies have pioneered in North America in such important technological developments as the basic oxygen steel furnace, oxygen injection in open hearth, continuous casting, and direct reduction of iron ore.

This drive toward improved technology must continue if the Canadian industry is to compete effectively and keep its dominant share of the domestic market. Foreign competitors are growing and improving their methods. The industry in the United States has been carrying out an extensive modernization program. The Japanese industry is carrying out a program of growth and technological advance in its seaboard steel industry unparalleled anywhere in the world. And there are big developments in Europe and in Australia. Canada must keep up or fall behind. This means continuing heavy investment in new plant and equipment between now and 1980.

The minimum amount needed in the seventies -- $3 billion -- is twice as much as was spent in the sixties. It will be difficult enough for the industry to find the necessary funds under present tax arrangements let alone under less favourable ones. Capital is scarce and expensive and demands for it are expected to remain very strong. This is no time to impair the industry's ability to generate funds internally and to compete effectively.

We have made some projections of the financial position of the three companies in the seventies to determine the potential impact of the proposed drastic cut in the mining incentives. The internal cash flow would be sharply reduced and the rates of return would be lowered. As a result, the industry's dependence on raising outside funds in the seventies would be approximately doubled while its ability to raise outside funds would be substantially reduced. The practical results would be to increase the upward pressure on prices to consumers, increase Canada's dependence on imported steel products and reduce returns to shareholders. The industry's ability to obtain all the capital funds needed in the seventies would,

in fact, be open to grave question. Any one of these results would be detrimental to the industry, its employees, its suppliers, its customers and its shareholders.

We should add that the impact of the proposed reduction in the mining incentives could alter the course of the steel industry in a way which would take a long time to reverse. The industry has to look a long way ahead. Because of the time it takes to plan and carry out the large individual projects, and because of the close inter-relation of one project to another, decisions which must be made now will have a major effect on the pattern of development of the industry for some years to come. Any sizeable project undertaken now or in the near future will be just starting to get into efficient operation by the mid-1970's when the transition period on mining proposed in the White Paper comes to an end. The White Paper proposals affect investment decisions now and the doubt created by them has already had an impact on plans for expansion.

Closing Observations

Most countries regard steel as a basic industry to be encouraged as one of the corner-stones of a modern, industrial economy. In Canada, current mining incentives have encouraged and sustained rapid and efficient growth of a highly productive and internationally competitive basic steel industry. They have promoted a strong basic industrial position in Canadian hands.

It should not be overlooked that if steel were produced elsewhere for Canadian consumption, the Canadian consumer would face the problems of variable deliveries and highly variable prices which have been typical of off-shore imports. Nor should it be forgotten that, if iron ore which might have been produced in Canada is imported, a strong impetus to better balanced regional development would be lost. The mining tax incentives are long-term policies, the value of which has been established by long-term results. In the light of the record, it would be

unwise to abandon a well tested and effective policy unless it is clear that the gains would definitely outweigh the losses. As stated at the outset, we have seen no evidence to support this conclusion and our own research leads quite decisively to a contrary opinion.

Our conclusion in the circumstances is simple. We have tested the White Paper proposals in the light of the expected circumstances of the seventies. We have concluded that the present incentives are sound and that they are in no way matched by the approach proposed in the White Paper. And for the steel industry, we are also convinced that continuation of these is essential if the industry is to perform as well in the seventies as it did in the sixties. We think it will be generally agreed that Canada needs a high level of performance by the steel industry in the new decade every bit as much as it did in the past decade.

The present incentives to mining have been ideally suited to this capital intensive and deeply integrated Canadian industry. The steel industry is integrated right through from the natural resource to the finished product. It is precisely the kind of industry Canada needs.

No system of taxation is perfect, but, based on the evidence, the present mining incentives appear to be uniquely suited to the development of the Canadian integrated steel industry. The White Paper proposals, on the other hand, are not conducive to the continued dynamic growth of Canadian iron ore mining or the integrated steel industry. Specific areas in which the proposals are deficient from our point of view include:

(1) The determination of incentives by reference to expenditures, which is not at all suited to the peculiar characteristics of the integrated steel industry.

(2) The relating of incentives to new mines, to the exclusion of expansion or extension of existing projects.

(3) The discontinuance after 1975 of the present depletion incentive based solely on profits from existing properties, in which huge sums have been invested predicated on tax legislation existing at the time the investments were made.

We have explored some possible alternatives but the complexities and ramifications of the problem make it difficult to arrive at constructive suggestions without knowing more about the motives behind the White Paper proposals.

APPENDIX A

THE STEEL INDUSTRY'S PERFORMANCE IN RELATION TO BROAD ECONOMIC OBJECTIVES

In terms of the broad economic objectives which most countries set for themselves today, the Canadian steel industry's record is impressive. It has contributed substantially to the goals of high employment, of rising productivity, of reasonable stability of prices, and of good external economic balance. Steel has been growing more rapidly than most other manufacturing industries; its average annual growth rate in the fifteen years from 1953 to 1968 was 6.8 per cent which compared with 5.4 per cent for manufacturing generally. The iron ore production of the steel industry in Canada has been rising at an annual rate exceeding 20 per cent in the 1960's. With a value added of production of about $700 million in 1968, it is the third manufacturing industry in Canada outranked only by pulp and paper and automobiles. It ranks eighth among the steel industries of the non-communist world and its rate of growth in the past decade has been exceeded among the larger countries only by Japan and Italy.

(1) High Employment

The steel industry employs directly about 45,000 people with an annual payroll of $305 million. As an employer, it ranks fourth among the manufacturing industries and, in terms of payroll, it ranks third. Average hourly earnings are relatively high and employment has been growing at about the same rate as total employment in Canada.

All things considered, the steel industry has probably made a better than average contribution to employment in Canada. As a capital-intensive industry, its indirect impact on the employment in the construction and machinery industries has been heavy. From 1959 to 1969, the steel industry's capital expenditures were $1.5 billion (including those made by the Canadian

steel companies in iron ore mining) and repair and replacement outlays on machinery were close to $1 billion. Of this total of $2-1/2 billion, over $2 billion was spent on machinery and equipment, the greater part of which was made in Canada. Thus there has been a major indirect effect on employment in businesses making machinery and equipment and on the suppliers of a variety of materials.

The industry has also contributed indirectly to employment by making available a growing volume and variety of steel products on a more economical and reliable basis than would have been possible if Canadian steel users had depended on imports. This has facilitated the development of secondary manufacturing industries in Canada enabling them to displace imports of competitive products and in some cases to develop exports of their own.

While the steel industry's direct effect on employment has been important, its indirect or "multiplier" effect has been very significant. Because it is capital-intensive and competitive, relatively more of the effects of its growth on employment are felt by industries supplying machinery and equipment and by industries benefiting from reliable supplies and lower prices of steel products.

(2) Rising Productivity

In the area of productivity -- of output per worker or per man-hour -- the record of the steel industry has been well above average. According to a recent study by the Dominion Bureau of Statistics, output per man-hour increased at an average rate of 4 per cent per year from 1959 to 1968 and this was about 1 per cent higher than the average for the private sector of the economy. If we take a longer period from 1953 to 1968 (because 1959 provides a rather high starting point), the average yearly rate of increase in output per man-hour in

the steel industry works out to 4.7 per cent. (Short-term comparisons of changes in productivity are frequently unreliable because fortuitous events such as strikes and the introduction of major new equipment can distort the significance of the data for a particular year. Much depends also on the opening and closing years of the comparison).

In any case, the increase in steel's productivity has been relatively high and is the explanation for the industry's ability in the last decade to strengthen its competitive position in relation to United States producers and to some competitive materials, and at the same time to pay relatively high and increasing real wages.

(3) Reasonable Stability of Prices

The industry has succeeded in keeping steel prices at a level that has greatly reduced Canada's dependence on steel imports and has helped to develop substantial exports. In 1968, Canada was no longer a net importer of steel whereas fifteen years ago her net imports were equivalent to 25 per cent of Canadian requirements.

Around 1961 the spread of Canadian base prices of steel over those of United States producers disappeared, and was superseded by a spread under United States prices which presently, even after the recent Canadian price increases, averages more than 15 per cent. This is one of the major reasons, combined with the widening range of Canadian production, for the displacement of United States and other imported steels in the Canadian market.

Even in absolute terms the price record of the steel industry is noteworthy. From 1959 to the end of 1969, steel prices in Canada rose about 11 per cent compared with 31 per cent for the consumer price index and 33 per cent for the implicit price index for gross national expenditure. The

increase in United States steel prices has been substantially greater as has been the rise in prices of competing materials such as non-ferrous metals. This is evidence of responsible pricing policies and efficient operations.

(4) Strengthening the Balance of Payments

Canadian steel has also played a significant role in strengthening Canada's external economic position. In 1968 (1969 figures were distorted by strikes in the industry), Canadian mills shipped over 11 million tons in raw steel equivalent and Canadian steel consumption was just about at the same level. Comparing this with net imports of steel equivalent to 25 per cent of Canadian steel requirements which were typical in the mid-1950's, we estimate that the savings in foreign exchange were approximately $300 million. This is a net figure which takes into account the sharply reduced level of net steel imports (reflecting declining imports and rising exports), the Canadian steel industry's substitution of Canadian for foreign sources of iron ore and adjustment for additional capital equipment and raw material imports. This is a substantial contribution to a better balance of payments at a time when it is difficult and expensive to meet deficits by borrowing abroad.

Performance in Relation to Special Canadian Objectives

In addition to the contributions to broad economic objectives, the development of the steel industry has also been in line with objectives which have a specific Canadian connotation. These include:

(1) Developing a Stronger Industrial Structure

Canada is in the midst of a rather difficult adjustment of her industrial structure to an increasingly competitive world. It has been said with a good deal of truth that Canadian industry which developed behind a

strongly protective tariff produces a surprising range of products but relatively few on an efficient internationally-competitive basis. During the years since the end of the second world war and particularly during the last decade, this country has been gradually adjusting its industry to international competition and increasingly looking to export markets that would provide a scale of operations large enough to permit efficient production. The process has been stimulated by a gradual reduction of tariff protection. What is more, real progress has been made. More and more Canadian manufacturers are specializing to meet import competition and a considerable number have developed export markets in their efforts to get the volume needed for greater efficiency.

The steel industry has made a significant contribution to this improvement in industrial efficiency. After all, steel is by far the most important industrial material. For a number of industries, including construction and automobiles, it accounts for more than 10 per cent of their total purchases and for some metal fabricating businesses 20 per cent, 30 per cent or more. The bulk of steel needed by Canadian industries is now available from domestic companies. Consequently, Canadian steel users are less dependent on imported supplies which vary in availability and time of delivery and are subject to wide price changes. For example, in the last eighteen months export price quotations on European steel have in some instances risen by more than 50 per cent. Canadian steel is available at prices which are usually below the cost of imported supplies. As noted earlier, Canadian prices average about 15 per cent less than United States base prices and when allowance is made for transportation and the tariff the laid-down cost of the United States product in Canada is even higher. In other words, the competitive position of the many industries that depend on steel in Canada has been strengthened by the growth and efficiency of

Canadian steel and this in turn has contributed to a stronger industrial structure.

(2) More Balanced Regional Development

The steel industry has also contributed to a better balance of regional development in Canada. One of the three companies, Algoma, has its principal operations at Sault Ste. Marie, and this major steelworks has played an important part in building a stronger economy in north-western Ontario. In addition, all three companies have mining operations in some of the less developed parts of Canada. These have created viable and prosperous communities where no other economic activity is feasible.

(3) Canadian Ownership and Control

The official statistics show that there are few industries where the proportion of Canadian ownership and control has remained as high as it has in the Canadian steel industry. One of the principal reasons is that the Canadian tax climate has stimulated the steel industry to invest larger and larger amounts in modern plants and technology and this has enabled Canadian-owned companies to keep pace with a growing market for steel products without the necessity of looking to foreign capital to finance this dynamic growth.

APPENDIX B

SUMMARY OF SUPPLY AND DEMAND TRENDS IN IRON ORE TO 1980

This memorandum outlines the world demand and supply situation for iron ore to 1980. It is based primarily on a United Nations study published in 1968, showing regional reserves and demand projections for 1970, 1975 and 1980*. The iron ore demand projections in this study are based on regional steel production forecasts which take into account historical growth rates, per capita consumption trends and a number of other variables. Since it was felt that an overestimate of future iron ore requirements would be preferable to a shortfall, the steel projections are relatively optimistic.

Iron ore reserves are abundant and are well distributed around the world. The factors which will determine the growth in output in specific countries and regions can be summarized as follows:

(1) The comparative costs of producing from existing ore bodies and developing new mines in individual regions. This includes a large number of cost determining factors, including the ferrous content of individual ore bodies and attendant beneficiating or agglomerating operations.

(2) Transportation costs and links which will be particularly important for export-oriented operations. Australia's importance as an iron ore supplier to Japan is enhanced by the relatively short distance between the two countries, and the favourable location of both ore properties and steel plants.

---

* United Nations, Economic Commission for Europe, The World Market for Iron Ore, 1968.

(3) Development and production incentives provided by government policy, which may be regarded as necessary because of the wide disparities in the quality of ore resources, will also play an important role in determining actual output trends. For this reason, the taxation of mining industries in individual countries will be a significant factor in determining the location of future investment and relative growth rates.

The leading world producers of iron ore for the years 1965-1968 are summarized in Table 1. World shipments of iron ore in 1968 amounted to an estimated 630 million metric tons, which was fractionally above 1967.

Reserves

The United Nations estimated in 1966 that world reserves of iron ore totalled 248,200 million tons of measured reserves and 205,000 million tons of additional potential ore. Table 2 gives a detailed breakdown of these reserves by region and country. These figures are probably subject to upward revisions, although in the case of large low grade ore bodies, downward corrections should be made if future economic conditions limit mining to the richest areas of such deposits, as new reserves are discovered. In the countries possessing the largest reserves, such as the U.S.S.R., the United States, Canada, India, Brazil and Sweden, reserves are already sufficient for several decades. It is mainly the new countries of Africa and the Far East and the undeveloped countries of South America, Australia and China (mainland) for which the most pronounced increases in resources and reserves can be expected to take place in the future.

Existing iron ore reserves appear sufficient to cover foreseeable requirements until the end of the century. If iron ore production continues to expand at an annual average rate of 5 per cent, the 250,000 million tons of reserves which have been estimated in Table 1 would be exhausted by the year 2015.

The 200,000 million tons of potential ore known to exist will then be exploited. This source will be supplemented by new discoveries and exploitation of reserves which are at present uneconomic but which may be amendable to new treatment techniques.

Projected Pattern of World Production and Trade in 1980

Table 3 summarizes the U.N. production forecast for 1980. World production for 1980 is projected at 898 million tons with an estimated iron content of 514 million tons. The U.S.S.R., the United States, Canada, India, Brazil and Australia will produce 355 million tons of iron content or 69 per cent of the total. Within this group of producers, a dominating position will be occupied by the U.S.S.R., with nearly 35 per cent of the total output. Australia is another area which will experience phenomenal growth. Most of the Australian production will be consumed by Japan. Production in the E.E.C. and the United Kingdom, the former large producers in Western Europe, will not exceed 18 million tons of iron content in 1980 compared with 28 million tons in 1964.

The U.N. forecast assumes that Canadian output will increase moderately, reaching 58.0 million metric tons (actual tonnage) in 1980, compared to 44.8 million metric tons in 1968. United States production is also expected to rise slowly, and amount to 98.0 million metric tons in 1980, compared to 84.7 million metric tons in 1968.

Chart 1 summarizes actual international trade patterns in 1964 and the 1980 projections.

By 1980, the European market is expected to absorb 39 per cent of total world imports and Japan 23 per cent. The requirements of the E.E.C., the U.K. and Japan will continue to expand rapidly while Eastern Europe and the United States will increase more slowly, because of the relatively low rate of

growth of their steel production or because of utilization of local ore. The largest proportion of Canadian exports will continue to go to the U.S. Exports to the E.E.C. and Western Europe will increase, but remain under 5 million tons. Japanese consumption will be satisfied primarily from Australia and Latin America.

TABLE 1

LEADING WORLD PRODUCERS OF IRON ORE

CONCENTRATES AND AGGLOMERATES

1965 – 1968

(Million Metric Tons)

	1965	1966	1967	1968(p)
U.S.S.R.	152.9	160.0	167.9	–
United States	89.2	91.5	85.5	84.7
France	59.5	55.0	49.8	55.7
Canada	36.2	36.8	38.4	44.8
China	39.0	40.0	32.0	–
Sweden	29.4	28.2	28.7	32.8
India	16.8	26.3	25.8	–
Brazil	17.4	21.0	25.2	24.3
Australia	6.8	11.7	18.9	20.3
Liberia	15.9	16.8	18.9	–
Venezuela	17.3	17.7	17.1	15.7
United Kingdom	15.6	12.7	12.8	13.2
Chile	11.3	12.2	11.5	–
West Germany	10.8	9.4	8.5	7.7
Other Countries	97.1	90.1	87.2	–
World Total	616.0	630.0	629.1	629.9

(p) Preliminary

Source: Dominion Bureau of Statistics.

TABLE 2

WORLD IRON ORE RESERVES
AND POTENTIAL RESOURCES
1966 ESTIMATE
(Billions of Tons)

	Reserves	Potential Ores
Western Europe	20	6
Eastern Europe	104	14
Total Europe	124	20
North America	53	93
South America	42	42
Total America	95	135
Africa	13	14
Far East and Middle East	8	29
Oceania	8	7
Total World	248	205

TABLE 3

Forecasts of iron-ore production in 1980
(Million tons)

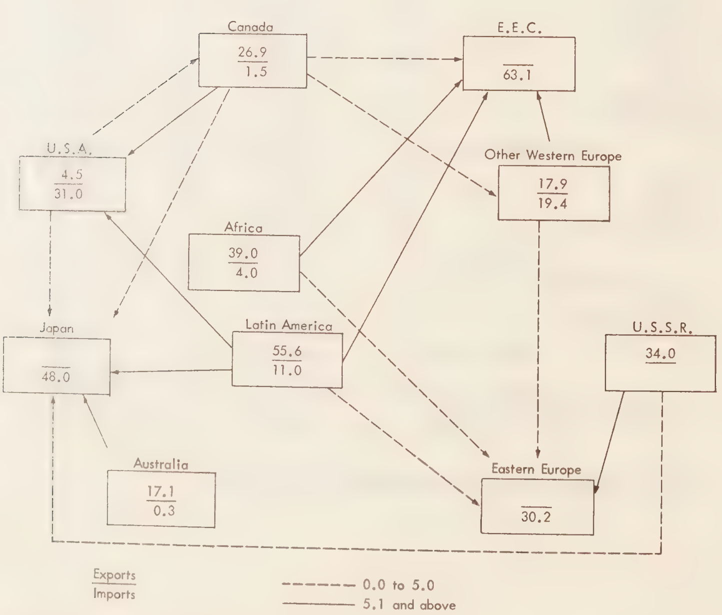
Regions and countries	Actual tonnage		Iron content	
	Forecast	Range	Forecast	Range
France	42.0	39.0- 45.0	13.0	12.1- 13.9
Rest of EEC	9.0	8.0- 10.0	2.7	2.4- 3.0
EEC, total	51.0	47.0- 55.0	15.7	13.5- 16.9
Norway	3.5	3.3- 3.7	2.2	2.1- 2.3
Sweden	35.5	34.0- 37.0	22.7	21.0- 23.0
United Kingdom	7.5	6.8- 8.3	2.0	1.8- 2.2
Rest of western Europe	34.0	32.0- 36.0	15.0	14.0- 16.0
Western Europe, total	131.5	123.1-140.0	57.6	52.4- 60.4
USSR	305.0	285.0-330.0	174.0	158.0-188.0
Rest of eastern Europe	15.0	14.0- 16.0	4.8	4.5- 5.1
Eastern Europe, total	320.0	299.0-346.0	178.8	162.5-193.1
TOTAL EUROPE	451.5	427.1-486.0	236.4	214.9-253.5
Canada	58.0	54.0- 63.0	37.0	34.0- 40.0
United States	98.0	95.0-100.0	60.5	59.0- 62.0
North America, total	156.0	149.0-163.0	97.5	93.0-102.0
Venezuela	26.0	24.0- 28.0	16.7	15.5- 18.0
Brazil	45.0	30.0- 70.0	29.0	19.0- 45.0
Peru	11.0	10.0- 12.0	6.8	6.2- 7.4
Chile	17.0	15.0- 27.0	10.9	9.7- 17.0
Rest of Latin America	9.0	8.0- 10.0	5.5	5.0- 6.0
Latin America, total	108.0	87.0-147.0	68.9	55.4-93.4
TOTAL AMERICA	264.0	236.0-310.0	166.4	148.4-195.4
North Africa	8.0	7.5- 13.0	4.2	4.0- 7.1
Mauritania	8.0	5.0- 10.0	5.0	3.1- 6.3
Liberia	26.0	24.0- 28.0	16.5	15.2- 17.8
Sierra Leone	3.5	3.1- 4.0	2.2	1.9- 2.5
Gabon	12.0	8.0- 16.0	7.7	5.1- 10.2
Angola	5.1	5.1- 6.0	3.2	3.2- 3.8
South Africa	10.1	9.3- 10.7	6.1	5.6- 6.5
Rest of Africa	4.0	3.5- 10.0	2.1	1.8- 6.0
TOTAL AFRICA	76.7	65.5- 97.7	47.0	39.9- 60.2
India	49.0	42.0- 55.0	29.2	25.7- 34.0
Japan	3.6	3.6- 3.6	2.0	2.0- 2.0
Malaysia	5.0	4.0- 10.0	3.0	2.4- 6.0
Rest of Far East	9.0	8.0- 10.0	4.5	4.0- 5.0
TOTAL FAR EAST (EXCLUDING CHINA (MAINLAND))	66.6	57.6- 78.6	38.7	34.1- 47.1
Australia	38.0	35.0- 45.0	24.5	22.6- 29.0
Rest of Oceania	1.1	1.0- 1.2	0.6	0.5- 0.7
TOTAL OCEANIA	39.1	36.0- 46.2	25.1	23.1- 29.7
GENERAL TOTAL (EXCLUDING CHINA (MAINLAND))	897.9	817.2-1017.8	513.6	460.4-585.8

Source: The United Nations, The World Market for Iron Ore, 1968.

Chart 1

PATTERN OF WORLD TRADE IN IRON ORE

1964



Source: United Nations, Economic Commission for Europe, The World Market for Iron Ore, 1968.

Note: All figures are in metric tons.

APPENDIX "B"

NAME: JOINT PRESENTATION OF
THE ALGOMA STEEL CORPORATION LTD.,
DOMINION FOUNDRIES AND STEEL LTD.,
THE STEEL COMPANY OF CANADA LTD.,

SUBJECT: Mining

Analysis of Appendix "A" by Senior Advisor

This brief is a joint presentation of The Algoma Steel Corporation Limited, Dominion Foundries and Steel Limited and The Steel Company of Canada Limited. These three companies employing some 45,000 persons account for 80% of Canada's output of iron and steel, the production of which has increased more than fourfold since 1946. The companies have major plans for expansion during the next ten years.

The brief presents the joint views of the three companies respecting mining incentives and draws five conclusions, which are:

1. The mining incentives have been an effective part of Canadian economic policy as they have affected iron ore mining and the Canadian steel industry. This has had a strongly favourable impact on the entire Canadian economy.

   (Pages 2 and 3 of the brief)

2. The seventies are going to present a real challenge to the Canadian steel industry even without adverse changes in tax laws.

   (Page 3 of the brief)

3. In these circumstances, adoption of the White Paper proposals with regard to the mining incentives would seriously curtail the growth and efficiency of a Canadian industry essential to the healthy development of the industrial economy.

   (Page 4 of the brief)

4. The proposals for integration of corporate and personal income taxes would seriously reduce the effectiveness of the present mining incentives. Since the benefits of the incentives would not be passed on to shareholders through tax credits, the industry's capacity to raise outside capital would be considerably reduced in relation to business generally.

   (Page 4 of the brief)

5. Any reduction in capital cost allowances, which the White Paper suggest will be studied later, would further weaken the contribution of the steel industry to healthy economic growth in Canada and, like the proposals for reduction of the mining incentives, would be inappropriate, particularly at this stage of Canada's economic development.

   (Page 4 of the brief)

The brief concludes with the following:

"Specific areas in which the proposals are deficient from our point of view include:

(1) The determination of incentives by reference to expenditures, which is not at all suited to the peculiar characteristics of the integrated steel industry.

(2) The relating of incentives to new mines, to the exclusion of expansion or extension of existing projects.

(3) The discontinuance after 1975 of the present depletion incentive based solely on profits from existing properties, in which huge sums have been invested predicated on tax legislation existing at the time the investments were made.

We have explored some possible alternatives but the complexities and ramifications of the problem make it difficult to arrive at

constructive suggestions without knowing more about the motives behind the White Paper proposals."

The brief does not make any specific recommendations or suggestions other than to state that the present system of incentives has worked successfully and the proposals of the White Paper would not in their opinion be successful.

The brief on page 7 makes reference to a study made comparing the operating results of four existing mines under the present tax system and the White Paper proposals. This study is not included in the information submitted.

The attention of the Committee is drawn to the following remarks:

1. At this time, however, we wish to draw your urgent attention to the probable consequences for the Canadian steel industry of the proposed sharp curtailment of the mining incentives. There is no doubt that the changes in the mining incentives set out in the White Paper would have a major negative effect on iron ore mining in Canada. Nor is there any question that, through their impact on the costs and earnings of the steel companies, the proposed changes in the mining incentives would significantly weaken the competitive position of the Canadian steel industry and inhibit its expansion in the years ahead.

   (Page 1 of the brief)

2. No Government studies of the impact of the proposed changes in the mining incentives on iron ore mining or on the Canadian steel industry have been made available. It is, therefore, not clear whether the unfavourable economic consequences which would flow from these changes were foreseen by the authors of the White Paper and regarded by them as an acceptable price to pay. We frankly doubt whether the probable consequences were in fact anticipated, since it is difficult indeed to imagine them as being acceptable.

   (Page 2 of the brief)

3. We wish to make it clear that the mining incentives have what might be described as a double effect in their application to the steel industry. They do much more than stimulate the mining of iron ore, important as that is. The steel companies are only looking for raw materials to feed their furnaces, not for minerals to sell. They must get iron ore somewhere and the incentives have been a very effective way of seeing that Canadian rather than imported ore has supplied the great increase in their needs over the past decade. What is equally

important is that the incentives have in effect provided lower cost ore, which has improved the earnings and internal generation of funds of the industry and thus stimulated its growth and efficiency from the mine right through to the finished steel product. So, for steel, the present rules have turned out to be a potent force for growth of the whole integrated industry. The value of the incentives should be judged in these terms and not by their benefits to iron ore mining alone.

(Page 5 of the brief)

4. Under the changes proposed in the White Paper, exploration and development expenditures relating to mining would become the cruicial factor in the mining incentives, replacing the tax exemption for new mines and the present system of percentage depletion. For steel companies, exploration outlays represent a relatively small part of the total investment in mining. There is in fact a good deal of ore owned or leased and ready to be developed if the economics justify doing so. The effects of the proposed changes on the steel industry would be to eliminate about three-quarters of the value of the incentives.

(Page 5 of the brief)

5. The system now in effect has the great merit that it works, and works well.

(Page 5 of the brief)

6. We have looked at the four largest mines -- the Sherman, Griffith, MacLeod and Wabush -- which the three companies have developed or have had a part in developing during the sixties. We have taken the actual results to date and projected results for the estimated lives of the mines to determine the expected rates of return under the existing tax system. Those rates of return have been recalculated on the assumption that the proposals with respect to mining incentives in the White Paper had been in effect from the beginning in each case. The difference is major in all

cases and the proposals would have cut the average rate of return on investment by almost one half. A reduction of this magnitude in the rate of return has serious implications. It would have removed the inducement offered to Canadian steel companies to develop their own iron ore mines in Canada. It is doubtful if any of these developments would have gone ahead if the White Paper proposals had been in effect.

(Page 7 of the brief)

7. Two of the companies have to decide soon whether or not to expand the Wabush operations. Because this is an expansion of an existing mine rather than a new mine, the effect of the White Paper would be slightly less severe although it would still mean a substantial decline in the rate of return. The United States partners in Wabush are doubtful about participating in this expansion and concerned at the possibility implied in the White Paper of a sharp cut in the rate of return on their earlier investment.

(Page 8 of the brief)

8. The White Paper proposals would take the emphasis off Canadian developments and place it on foreign alternatives.

(Page 9 of the brief)

9. No system of taxation is perfect, but, based on the evidence, the present mining incentives appear to be uniquely suited to the development of the Canadian integrated steel industry.

(Page 14 of the brief)

APPENDIX "C"

SUBMISSION TO THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

BY

THE STEEL COMPANY OF CANADA, LIMITED

ON

THE GOVERNMENT'S PROPOSALS FOR TAX REFORM

WEDNESDAY, MAY 6, 1970

21889—7½

CONTENTS

SUBMISSION ON THE GOVERNMENT WHITE PAPER

entitled

"PROPOSALS FOR TAX REFORM"

I THE STEEL COMPANY OF CANADA, LIMITED

1.1 The importance of the steel industry to Canada is outlined in a joint submission to the Senate and Commons Committees by the three major Canadian steel producers -- Algoma, Dofasco and Stelco.

1.2 The Steel Company of Canada, Limited (Stelco), is the largest of the three companies and has been in the forefront of steelmaking in Canada from the beginnings of the industry. Stelco has grown and prospered with Canada and today, producing 40% of the nation's steel, employs more than 22,000 people. The Company is distinctly Canadian with 50,000 shareholders and almost 95% of its shares held by Canadian residents.

1.3 Although Stelco is large by Canadian standards, in terms of output it ranks 24th among steel producers in the free world. Several of these other producers have much greater steelmaking capacity than Stelco -- some as much as six times greater. In fact, Canadian output of steel is less than 2% of total world production, which underlines the dimensions of the problem the Canadian companies face in competing in domestic and foreign markets for steel. The tax structure should not make competition in these markets more difficult for us.

1.4 In addition, Stelco depends primarily on the prosperity of the Canadian economy for the major portion of its business. Because of this, it is apprehensive about tax reform proposals which threaten to disrupt the strong potential for growth characteristic of industrial development in Canada in the last fifteen years.

II CANADA'S TAX SYSTEM

2.1 Stelco believes that a vigorous, growing economy is essential if Canada is to achieve its social goals. The tax system, because of its significant influence on the economy, should be designed to foster this economic vitality and nation-wide growth. While selective measures to improve the equity of the tax system are to be encouraged, a balance must inevitably be struck between equity and growth-oriented policies. In Stelco's view, the most appropriate tax system for Canada is one which favours growth, increasing employment and a better regional balance, even at the expense if necessary of some degree of equity and an immediate increase in government revenues.

2.2 While economic growth should be a prime objective of Canada's federal tax system, agreement between the federal and provincial governments on tax structure and tax jurisdiction is fundamental. Moreover, because of the openness of the Canadian economy, the Canadian tax system cannot be significantly different from the tax systems of competing economies. That is, Canadians should not be put at a competitive disadvantage through the operation of the Canadian tax laws.

III THE WHITE PAPER IN GENERAL

3.1 Stelco believes that the Government's tax reform proposals, as a package, would impede the growth of the private sector of the Canadian economy for some years to come, and would retard progress in removing regional disparities. The following comments, representing our general appraisal of the White Paper, are presented prior to discussing some of the specific proposals in more detail.

3.2 The Economic Council estimates that an average annual real increase of 5.8% in capital investment will be required in the first half of the Seventies if Canada is to reach her economic potential. Certainly if expansion demands on the steel industry are an indication, new capital requirements of the private sector will become increasingly intense, and a high level of saving will be essential for Canadians to retain their present degree of control of Canadian business. This saving will have to be induced by a growth-oriented fiscal policy. That the White Paper underrates the need for such a policy is evident from the proposals that would:

(i) produce a significant increase in government revenue, without indicating an equivalent expenditure need.

(ii) reduce the incentives to develop iron ore resources.

(iii) eliminate the low corporate tax rate, without providing adequate incentives for small companies to grow.

(iv) shift a substantial portion of the income tax load to middle income taxpayers.

(v) tax capital gains on a more severe basis, in many cases, than prevails in more mature countries with many years of experience in this field.

3.3 The White Paper also fails to place its proposals within the context of all federal taxes, transfer payments and subsidies. We believe implementation of the tax reform proposals would be premature without a full assessment of the incidence of all government expenditures and of other forms of taxation.

3.4 Insufficient recognition has been given to the importance of ensuring that provincial cooperation in the development of an overall Canadian tax system is obtained before considering enactment of the White Paper proposals.

3.5 Finally, as mentioned earlier, if all the proposals were adopted, federal government revenue would increase substantially. Until full justification of the need for the added revenue is presented, we believe the increase in the federal government's share of Canada's Gross National Product to be unwarranted.

IV COMMENTS ON SPECIFIC PROPOSALS

4.1 A number of specific proposals in the White Paper, in our opinion, would have unfortunate consequences if enacted. Our comments on them follow.

4.2 Mining: Our views on the effects of the proposals regarding taxation of iron ore mining have been expressed in detail in the submission by the steel industry referred to earlier. We do not propose to repeat what was said in that statement, but we would like to summarize the main conclusions here:

(a) The existing mining incentives have had a favourable impact on the Canadian economy by encouraging iron ore developments that would not otherwise have been undertaken, and by keeping down the cost of iron ore and steel products, thereby greatly strengthening the competitive position of Canadian steel producers.

(b) Increasing competition and a need for large amounts of new capital in the Seventies will present a real challenge to the steel industry, even without adverse changes in the tax laws.

(c) Adoption of the White Paper proposals would adversely affect the economics of iron ore development projects in Canada, thus raising the cost of producing steel and impairing the ability of the industry

to raise capital for expansion and to compete effectively in international markets.

4.3 Stelco's plans for expansion in this decade, estimated to cost well over one billion dollars if carried out, can make an important contribution to the development of the Canadian economy and the prosperity of its citizens. For example, the Company has recently acquired a large tract of land at Nanticoke on Lake Erie as a site for a completely new steel plant. This will provide an opportunity not only to greatly expand capacity but to incorporate the most modern and efficient facilities and production methods available. A necessary part of this expansion will be development of additional iron ore resources, opportunities for which are now available in Canada and in other countries. The ability of the Company to carry out this program successfuly will be dependent on its ability to raise the necessary capital without impairing its competitive position.

4.4 The mining incentives have been important to Stelco's success in financing its expansion of Canadian iron ore mines and steel production capacity in the Sixties, while at the same time helping the Company to maintain stable prices. A continuation of adequate incentives will be equally important to the projected expansion of the Seventies.

4.5 If, however, a change in the present mining incentives is considered necessary, it should be recognized that the principal problem in the iron ore industry is not one of discovering new deposits but rather of making the development of known deposits economically attractive. An incentive based on exploration and development expenditures, therefore, would provide little encouragement to Stelco to develop new mines in Canada. Retention of an incentive provision related to the taxation of potential profit would be far more effective and we, therefore, strongly suggest that the tax rules

continue to recognize this principle.

4.6 Integration: Stelco's chief concern about integration of corporate and personal income taxes on dividends is with the impact on the raising of capital and on administrative costs.

4.7 We realize integration is closely linked with several other White Paper proposals, and that a change in the integration concept could affect other parts of the proposed system. Nevertheless, we question whether there is a sufficient degree of double taxation of corporate income to justify a credit in the hands of the shareholders of as much as 100% of the corporation tax paid. The objective of most corporations is to earn enough after-tax income to give shareholders a reasonable return on their investment. We are of the opinion, therefore, that general price levels reflect a major portion of the corporation tax paid.

4.8 However, whether this view is acceptable or not, we believe the proposal is questionable for these reasons:

(a) A distinction is made between widely-held and closely-held companies. The logic of the distinction is hard to follow when widely-held and closely-held corporations are in direct competition with one another. Differentiating in this way would seem to confer an unwarranted benefit on the shareholders of companies defined as closely-held.

(b) Since creditable tax would be based on the amount of tax the corporation has actually paid, it would either negate the purpose of incentives in the income tax law (which result in a reduction in the effective tax rate on earnings) or would discriminate among shareholders of different corporations by providing for varying proportions of creditable tax. This problem would be accentuated in a multi-company organization, in situations where dividends paid by a Canadian subsidiary to its Canadian

parent company did not qualify for full creditable tax. In such cases, the benefit of the incentive to the organization would be lost immediately, and possibly long before the funds reached the individual shareholder of the parent.

(c) If credit for the corporation tax is to be made available to the shareholders, the 2-1/2 year limit for declaring dividends is illogical in view of the arguments used to support integration. If double taxation exists, and, therefore, integration should be introduced to correct the condition, the need for correction does not disappear after 2-1/2 years. The limitation might not be serious where shares are closely held, and there is opportunity for making distributions in stock, or for varying the rates of cash distribution with reasonable certainty that the capital will still be available to the business. It is particularly inappropriate for widely-held corporations, where stable dividend policies are important, and where business or capital investment are cyclical.

(d) The impact on the capital market of enacting the integration proposal cannot be determined in advance. However, it seems likely that shareholder pressure for cash dividends would increase in order to use the credits fully. This could create serious problems in raising adequate amounts of equity capital, merely because many corporations would be forced to go to the market frequently to recover the capital they would otherwise have retained from earnings. At the same time, the total capital available could be expected to be depleted as a result of the use of a portion of the higher dividend distributions for consumption purposes. On the other hand, interest rates would tend to rise to compensate for the fact that tax credits would not be available on interest income. This could again cause difficulties for business in obtaining borrowed capital at reasonable rates of interest.

(e) The proposal to provide a "flow-through" of foreign withholding taxes to non-resident shareholders would reduce Canadian tax revenue, without, in many cases, relieving the non-resident as far as his total burden of taxation is concerned. Consequently, it would result in shifting Canadian tax revenue to foreign countries. We suggest that such a theory has no place in international taxation.

(f) The complexities of the integration proposal would make control difficult and add to the administration costs of both business and government. This seems to be an unnecessary penalty to pay for adopting a concept of such doubtful validity.

4.9 We would, therefore, suggest that, imperfect as it may be, Canada should retain some form of dividend credit system to encourage Canadian investment in Canadian equities. Consideration might be given to varying the amount of the dividend credit with variations in the proportion of Canadian source income to total income for the previous year.

4.10 Failing this, we believe careful consideration might be given to achieving the general objective of the proposal by permitting the deduction from corporate taxable income of dividends paid to Canadian residents at the time payment is made. This seems to us to be a much simpler approach. It would probably require limiting, on a cumulative basis, the tax recovery from the deduction to the amount of tax actually paid by the corporation. While it may not always be possible to determine positively that a recipient of a dividend is in fact a Canadian resident, the degree of error probably would not be sufficient to outweigh the advantage of simplicity.

4.11 Capital Gains: Possibly there is some justification for introducing a capital gains tax at this time. However, Canada's needs for capital in the years

ahead will become more pressing, and we believe such a tax should interfere as little as possible with the ability of Canadians in the private sector to accumulate capital to meet these needs. Unduly heavy capital gains taxation, particularly when combined with the present estate taxes, could lead to a greater degree of foreign control of Canadian business.

4.12 More specifically, we believe that the tax as outlined in the White Paper has several undesirable aspects:

(a) It would fail to recognize the effects of inflation, and at the same time it would be imposed at higher rates than those levied in some more highly developed countries.

(b) It would not necessarily be imposed, as the White Paper suggests, principally on upper income bracket taxpayers. We understand that evidence from the United States indicates that by far the greatest proportion of capital gains, and tax revenue derived from them, is attributable to middle income bracket taxpayers, a group whose ordinary income would be taxed much more heavily under the White Paper proposals.

(c) The tax would be levied on gains presumed to have been derived on the disposal of a taxpayer's principal residence. We believe this to be unjustifiable and, in spite of protestations to the contrary, exclusion of a fixed annual increment (such as the $1,150 proposed in the White Paper) would not result in exemption of all such gains from the tax.

(d) Taxation of all items of personal property having a value in excess of a certain minimum, in addition to the taxation of share holdings and residences, would create vast record keeping problems for both

government and taxpayer. Judging by the experience of other countries where capital gains taxation has existed for years, it is questionable whether the amont of revenue to be derived would justify the administrative cost.

4.13 The feature of the capital gains tax proposal which most directly affects Stelco is that concerning the quinquennial revaluation of shares of widely-held corporations. We view this proposal with some anxiety for the following reasons:

(a) It would impose a tax on income before it was realized, or which might never be realized. We consider such a concept unacceptable within a framework of "income" tax legislation.

(b) It would discriminate between owners of shares of widely-held Canadian corporations and holders of other forms of investment. In many cases, it could require liquidation of the investment to pay the tax.

(c) It would have an adverse effect on the terms on which widely-held corporations could raise equity capital by making investment in foreign equities relatively more attractive. This would be a result opposite to that presumably considered desirable under the integration proposal.

4.14 If a capital gains tax is to be introduced in Canada at this time, we believe:

(a) It should be patterned after the United States capital gains tax.

(b) A flat rate tax of no more than 25% should be imposed. To lessen the initial impact, such a rate should be approached gradually over a period of years.

(c) No distinction should be made between widely-held and closely-held corporate shares.

(d) A distinction, similar to that in the United States between assets held for more and less than six months, should be made.

(e) Provision should be made for "roll-over" on disposal of a principal residence.

(f) A much higher minimum value than that proposed in the White Paper should be established for personal property subject to capital gains taxation.

4.15 Single Corporate Tax Rate: The proposed removal of the low corporate tax rate would have little direct effect on Stelco. Nevertheless, the Company's growth is closely related to the growth of the Canadian economy, and we, therefore, have an interest in the economic welfare of the smaller corporations.

4.16 We think it is important to give careful consideration to the economic effects of a change of this kind. The dual rate has existed for a number of years and is matched by a similar rate structure in the United States. Its elimination would undoubtedly cause dislocations to small business, unless relief was provided in some other form.

4.17 It does not disturb us to contemplate the continuation of the low tax rate for corporations, even though integration of corporation and shareholder income may ultimately be adopted. Nevertheless, if a change is to be made, we believe that some system of deferred tax credits to finance growth in working capital and net fixed assets should be considered. Annual limits on the amount of deferred tax (say $10,000) and a maximum

cumulative limit (say $100,000) could be developed, with payment required if funds were used other than to finance business assets, or if the company were sold.

4.18 International Taxation: Stelco supports any effort to prevent the use of foreign "tax havens" to artificially reduce the amount of Canadian taxes payable. However, many Canadian businesses conduct bona fide international operations, in the course of which their foreign income may be taxed at less than the prevailing Canadian rate. These are not situations in which improper advantage is being taken of the tax law. Rather, the Canadian business is being taxed in the same way as its foreign competitor. An attempt, therefore, to collect additional Canadian taxes on foreign income where Canadian tax rates may be higher than those of the foreign country could impair the competitive position of Canadian business. Extreme care must be used to distinguish between the bona fide and the artificial business transaction.

4.19 We are particularly concerned with these two aspects of the White Paper proposals:

(a) The proposed restriction of the exemption of dividends from 25% owned subsidiaries to dividends from countries with which Canada has a tax treaty could create unfair discrimination. We think it would be wrong to place Canadians at a competitive disadvantage simply because the Government has been unable to negotiate a tax treaty with the country concerned. There are severe problems here, not only because of the large number of countries with which Canada does business and where no treaty now exists, but also because of the fact that many of these countries will not be willing -- and certainly within the time limit set out in the White Paper -- to enter into an agreement with Canada.

(b) The treatment of certain categories of foreign income as "passive income" subject to full Canadian tax could also constitute unfair taxation. Many Canadian businesses, including Stelco, would be restricted in their ability to compete effectively in certain foreign markets without the incentive afforded by lower tax rates than Canada's. When it is either necessary or expedient to carry on bona fide business operations in one foreign country through a foreign corporation whose shares are held by another foreign subsidiary, dividends, interest, etc., originating from business operations of the first company should not constitute passive income of the second.

4.20 Pension Plans: Stelco agrees with the general objective of encouraging investment in Canadian equities. We believe, however, that the proposal to limit foreign investments of pension funds to 10% of total assets could create serious problems in pension fund administration for the following reasons:

(a) There has been a marked shift in recent years from investment in fixed income securities to investment in equities, where higher rates of return from dividends and capital appreciation have been available. This trend, in combination with a curtailment of investment in foreign securities, could create a demand for Canadian equities far exceeding the supply, with a consequent overvaluation of Canadian stock prices.

(b) A reduction in the allowable proportion of foreign investment could also affect the security of pension funds by restricting diversification. Many of the attractive investments available in the United States are either not available in Canada or are limited in their availability, e.g., the automotive, electronic, aerospace, office equipment, photographic, drug and cosmetic industries.

(c) In Stelco's experience, United States equities have out-performed Canadian equities in recent years. For instance, during various periods from 1961 to 1969, the annual growth rate of U.S. equities in a major Stelco fund ranged from 4.25 to 6.75 percentage points higher than that for Canadian stocks.

4.21 Because of the foregoing, the performance of Canadian pension funds could be seriously impaired by the proposal. The ultimate result would be higher corporate contributions to the funds with a consequent reduction in tax revenues and/or reduced future pension benefit levels.

4.22 We believe that it would be desirable to leave the limitation on foreign holdings at its current level of 10% of income of the fund. This in itself has an important influence on investment in Canadian equities. Failing this, however, we suggest there should be a period of at least five years allowed to comply with a change such as that proposed. A transition period of this length would be no more than reasonable to permit an orderly reduction in foreign holdings and to avoid the substantial risk arising from selling at unrealistic and sacrifice prices.

4.23 Income Averaging: The Company welcomes the acceptance in the White Paper of a need for an income averaging formula, available to all taxpayers, with simplicity being considered an important element in the calculation. However, we believe that the method proposed would be completely inadequate, if it is seriously intended to provide a reasonable measure of relief from taxation at maximum rates of unusual lump sum receipts such as severance payments and withdrawals from pension funds. The difficulty, of course, arises largely because the proposed personal tax rates are so highly progressive that the "maximum" rate is reached at a relatively low income level.

4.24 We feel that, if this proposal is adopted, serious consideration should be given to retaining the present provisions of Section 36 of the Income Tax Act.

4.25 Entertainment and Related Expense: The Company is not in agreement with the proposal to disallow these expenses, which in most cases are necessarily incurred to earn income. We see no reason for the statement that legitimate business expenses should be met from tax-paid income. The existing legislation contains adequate safeguards to prevent abuse, and we believe that the present staff of the Department of National Revenue is fully capable of coping with the problem.

4.26 Capital Cost Allowances: The statement is made in the White Paper that the present capital cost allowance system has served Canada well, but that after twenty years of use, the Government believes that it is time for a review. As a part of a highly capital intensive industry, Stelco would welcome an opportunity to present its views on the subject at an opportune time. As with the mining incentives, we believe that capital cost allowances have played a major part in contributing to the growth and strength of the steel industry and of the Canadian economy. In our opinion, any significant change in this simple and effective system should not be contemplated without very careful consideration of its economic impact.

V CONCLUSION

5.1 Stelco acknowledges that the present Canadian tax system is not perfect, and that changes to improve its equity are always desirable. We are not convinced, however, that the sweeping changes in tax policy proposed in the White Paper are in the best interests of Canadians generally. We believe that the prosperity of this country's citizens can be best achieved

in a tax climate that encourages individual saving, business growth, and the development of the nation's natural resources, and that improves the ability of Canadian business to compete effectively at home and abroad.

5.2 We also believe that changes in a tax structure are reflected sooner or later in price levels, wage and salary levels, and investment returns. The effect of changes made today in the name of equity, therefore, can be lost tomorrow as these relationships throughout the economy shift to reflect them.

5.3 The White Paper proposes the adoption of several concepts completely new to Canada, and their dislocating effects on the economy cannot be measured in advance. These and other proposals would impose a more complex and administratively costly tax system on Canadians. We believe that in attempting to reform the nation's tax structure, the federal government should carefully and thoroughly weigh the economic consequences of their proposals, recognizing the necessity for full cooperation with the provinces in the development of a sound and consistent system of taxation at all levels of government.

APPENDIX "D"

NAME: THE STEEL COMPANY OF CANADA LIMITED

SUBJECT: White Paper Proposals

Analysis of Appendix "C" by Senior Advisor

This Brief is submitted by The Steel Company of Canada Limited, one of the largest of the steel making companies in Canada, producing 40% of the nation's steel, employing more than 22,000 people. The company is owned by 50,000 shareholders and Canadian residents hold nearly 95% of the issued capital.

The Brief does not repeat the submissions made by the steel industry , it merely summarizes the main conclusions of that submission and concludes that portion of the Brief with the following comment:

> "If, however, a change in the present mining incentives is considered necessary, it should be recognized that the principal problem in the iron ore industry is not one of discovering new deposits but rather of making the development of known deposits economically attractive. An incentive basedon exploration and development expenditures, therefore, would provide little encouragement to Stelco to develop new mines in Canada. Retention of an incentive provision related to the taxation of potential profit would be far more effective and we, therefore, strongly suggest that the tax rules continue to recognize this principle."

(Pages 5 and 6,Paragraph 4.5 of the Brief)

The Brief comments upon the following proposals of the White Paper:

(1) Integration of corporate and personal income taxes . (Pages 6,7 and 8 of the Brief)

(2) Capital gains. (Pages 8,9, 10 and 11 of the Brief)

(3) Single corporation tax. (Pages 11 and 12 of the Brief)

(4) International income. (Pages 12 and 13 of the Brief)

The Brief also comments upon Pension Plans, Income Averaging, Entertainment and Related expenses and Capital Cost Allowances.

The attention of the Committee is drawn to the following comments in the Brief:

(1) Canadian output of steel is less than 2% of total world production, which underlines the dimensions of the problem the Canadian companies face in competing in domestic and foreign markets for steel. The tax structure should not make competition in these markets more difficult for us.
(Page 1, paragraph 1.3 of the Brief)

(2) Stelco depends primarily on the prosperity of the Canadian economy for the major portion of its business. Because of this, it is apprehensive about tax reform proposals which threaten to disrupt the strong potential for growth characteristic of industrial development in Canada in the last fifteen years.
(Page 1, paragraph 1.4 of the Brief)

(3) While selective measures to improve the equity of the tax system are to be encouraged, a balance must inevitably be struck between equity and growth-oriented policies.
(Page 2, paragraph 2.1 of the Brief)

(4) Because of the openness of the Canadian economy, the Canadian tax system cannot be significantly different from the tax systems of competing economies. That is, Canadians should not be put at a competitive disadvantage through the operation of the Canadian tax laws.
(Page 2, paragraph 2.2 of the Brief)

(5) Stelco believes that the Government's tax reform proposals, as a package, would impede the growth of the private sector of the Canadian economy for some years to come, and would retard progress in removing regional disparities.
(Page 2, paragraph 3.1 of the Brief)

(6) We believe implementation of the tax reform proposals would be premature without a full assessment of the incidence of all government expenditures and of other forms of taxation.
(Page 3, paragraph 3.3 of the Brief)

(7) Stelco's chief concern about integration of corporate and personal income taxes on dividends is with the impact on the raising of capital and on administrative costs.
(Page 6, paragraph 4.6 of the Brief)

(8) We question whether there is a sufficient degree of double taxation of corporate income to justify a credit in the hands of the shareholders of as much as 100% of the corporation tax paid. The objective of most corporations is to earn enough after-tax income to give shareholders a reasonable return on their investment. We are of the opinion, therefore, that general price levels reflect a major portion of the corporation tax paid.
(Page 6, paragraph 4.7 of the Brief)

(9) Unduly heavy capital gains taxation, particularly when combined with the present estate taxes, could lead to a greater degree of foreign control of Canadian business.
(Page 9, paragraph 4.11 of the Brief)

(10) The feature of the capital gains tax proposal which most directly affects Stelco is that concerning the quinquennial revaluation of shares of widely-held corporations. We view this proposal with some anxiety.

(Page 10, paragraph 4.13 of the Brief)

(11) An attempt, therefore, to collect additional Canadian taxes on foreign income where Canadian tax rates may be higher than those of the foreign country could impair the competitive position of Canadian business.

(Page 12, paragraph 4.18 of the Brief)

(12) We think it would be wrong to place Canadians at a competitive disadvantage simply because the government has been unable to negotiate a tax treaty with the country concerned.

(Page 12, paragraph 4.19 of the Brief)

(13) The conclusions of the Brief which are:

(a) Stelco acknowledges that the present Canadian tax system is not perfect, and that changes to improve its equity are always desirable. We are not convinced, however, that the sweeping changes in tax policy proposed in the White Paper are in the best interests of Canadians generally. We believe that the prosperity of this country's citizens can be best achieved in a tax climate that encourages individual saving, business growth, and the development of the nation's natural resources, and that improves the ability of Canadian business to compete effectively at home and abroad.

(b) We also believe that changes in a tax structure are reflected sooner or later in price levels, wage and salary levels, and investment returns. The effect of changes made today in the name of equity, therefore, can be lost tomorrow as these relationships throughout the economy shift to reflect them.

(c) The White Paper proposes the adoption of several concepts completely new to Canada, and their dislocating effects on the economy cannot be measured in advance. These and other proposals would impose a more complex and administratively costly tax system on Canadians. We believe that in attempting to reform the nation's tax structure, the federal government should carefully and thoroughly weigh the economic consequences of their proposals, recognizing the necessity for full cooperation with the provinces in the development of a sound and consistent system of taxation at all levels of government.

The Brief suggests:

(1) That, imperfect as it may be, Canada should retain some form of dividend credit system to encourage Canadian investment in Canadian equities. Consideration might be given to varying the amount of the dividend credit with variations in the proportion of Canadian source income to total income for the previous year.

(Page 8, paragraph 4.9 of the Brief)

(2) If a capital gains tax is to be introduced in Canada at this time, we believe:

(a) It should be patterned after the United States capital gains tax.

(b) A flat rate tax of no more than 25% should be imposed. To lessen the initial impact, such a rate should be approached gradually over a period of years.

(c) No distinction should be made between widely-held and closely-held corporate shares.

(d) A distinction, similar to that in the United States between assets held for more and less than six months, should be made.

(e) Provision should be made for "roll-over" on disposal of a principal residence.

(f) A much higher minimum value than that proposed in the White Paper should be established for personal property subject to capital gains taxation.

(Pages 10 and 11, paragraph 4.14 of the Brief)

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Iron Ore Mining

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Pages 4 and 5 of the Brief This portion of the Brief does not repeat the submission of the steel industry but merely summarizes the main conclusions which are: (1) Existing mining incentives have had a favourable impact on the Canadian economy. (2) Increasing competition and a need for large amounts of new capital in the Seventies will present a real challenge to the steel industry, even without adverse changes in the tax laws. (3) Adoption of the White Paper proposals would adversely affect the economics of iron ore development projects in Canada. (4) The need to raise capital to expand without imparing the competitive position. (5) The need to have adequate incentives to proceed with the projected expansions. This part of the Brief concludes with the following observation:

Name:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		If, however, a change in the present mining incentives is considered necessary, it should be recognized that the principal problem in the iron ore industry is not one of discovering new deposits but rather of making the development of known deposits economically attractive. An incentive based on exploration and development expenditures, therefore, would provide little encouragement to Stelco to develop new mines in Canada. Retention of an incentive provision related to the taxation of potential profit would be far more effective and we, therefore, strongly suggest that the tax rules continue to recognize this principle.

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Integration

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
This subject has been dealt with in Special Study No. 4 "Grossing-Up of Canadian Dividends" and is not repeated here.	See Special Study No. 4 for detailed review of White Paper proposals.	Page 6 of the Brief The Brief points out that: (1) Corporations seek to earn enough after tax income to give shareholders a reasonable return on their investment. (2) The general price levels reflect a major portion of the corporation tax paid. (3) Widely held and closely held corporations are in direct competition with one another. (4) An unwaranted benefit is conferred on shareholders of closely held corporations. (5) Creditable tax, based upon actual tax paid, would negate the purpose of incentives in the income tax law. (6) Creditable tax, based upon actual tax paid, would discriminate among shareholders of different corporations by providing for varying proportions of creditable tax. (7) If credit for the corporation tax is to be made available to the shareholders, the 2½ year limit for declaring dividends is illogical in view of the arguments used to support integration. (8) The complexities of the integration proposal would make control difficult and add to the administration costs of both business and government.

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Integration

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		The Brief suggests: (Page 8, paragraph 4.9 and 4.10 of the Brief) We would, therefore, suggest that, imperfect as it may be, Canada should retain some form of dividend credit system to encourage Canadian investment in Canadian equities. Consideration might be given to varying the amount of the dividend credit with variations in the proportion of Canadian source income to total income for the previous year. Failing this, we believe careful consideration might be given to achieving the general objective of the proposal by permitting the deduction from corporate taxable income of dividends paid to Canadian residents at the time payment is made. This seems to us to be a much simpler approach. It would probably require limiting, on a cumulative basis, the tax recovery from the deduction to the amount of tax actually paid by the corporation. While it may not always be possible to determine positively that a recipient of a dividend is in fact a Canadian resident, the degree of error probably would not be sufficient to outweight the advantage of simplicity.

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Capital Gains

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not levy income tax on many types of capital gains.	The White Paper Proposals relating to the taxation of capital gains were reviewed on Pages 8 to 20 of the special study entitled "Discussion of Principal Points of White Paper – Part 2" submitted on February 11, 1970.	Pages 8, 9, 10, and 11 of the Brief The Brief makes the following points: (1) The proposals fail to recognize the effects of inflation. (2) From information available it is indicated that in the United States – the capital gains tax falls hardest on the middle income group. (3) The taxation of gains from personal property would create vast record keeping problems. The Brief points out: (1) It would impose a tax on income before it is realized or which might never be realized. (2) It would discriminate between owners of shares of widely held Canadian corporations and holders of other forms of investments. (3) In many cases, it could require liquidation of the investment to pay the tax.

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Capital Gains

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		The Brief suggests that if a capital gains tax is to be introduced: (1) It should be patterned after the United Stated capital gains tax. (2) A flat rate of not more than 25% should be imposed, which rate should be approached gradually over a period of years. (3) No distinction should be made between widely held and closely held corporate shares. (4) A distinction should be made between short term and long term gains. (5) Provision should be made for "roll over" on disposal of a principal residence. (6) A much higher value than proposed in the White Paper should be established for personal property subject to capital gains taxation.

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Single Corporation Tax Rate

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The provisions of the present Income Tax Act relating to the lower rate of tax on the first $35000 of taxable income of a corporation have been reviewed in Special Study No. 5 "Taxation of Small Businesses" and are not repeated here.	These proposals have been reviewed in Special Study No. 5 and are not repeated here.	Pages 11 and 12 of the Brief This portion of the Brief suggests that it is important to the economic welfare of the country that the encouragement be given to small businesses.

Name: THE STEEL COMPANY OF CANADA LIMITED

Number Assigned:

Date Brief Received:

Date Brief Heard:

Principal Subject: International Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
Section 28-1-d of the Income Tax Act This section permits a Canadian company receiving a dividend from a foreign company to deduct from income subject to tax, the dividend received provided more than 25% of the issued capital is owned. No attempt is made to tax other foreign income until it is received.	1.47 There would be some changes in the taxation of income earned by Canadian residents and corporations from sources outside Canada to prevent "tax havens" being used to evade Canadian taxes. Individuals would continue to pay Canadian taxes on investment and other income from sources outside Canada. They would receive a credit for the withholding tax or other income tax paid directly to governments of other countries. Corporations would also receive such credits except when income is from a controlled foreign corporation.	Pages 12 and 13 of the Brief This portion of the Brief supports any effort made to prevent the use of foreign "tax havens" to artificially reduce Canadian taxes payable. The Brief points out that any attempt to collect additional Canadian taxes on foreign income where Canadian tax rates may be higher than those of a foreign country could impair the competitive position of Canadian business. The Brief points out two particular points: (1) The competitive disadvantage to Canadian business which could arise as a result of the inability of Canada to conclude treaties; and	

Name

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	1.48 New distinctions between classes of foreign corporations controlled from Canada are outlined in Chapter 6 and will be further elaborated in supplementary papers. Unless tax treaties provide otherwise, Canadian corporations would be taxed on dividends received from foreign corporations in which they have a substantial interest. However, they would receive credit for the withholding taxes levied on the dividend by the foreign country, and for the corporation tax paid by the foreign corporation on the profits from which the dividend was paid. Tax treaties would maintain the exemptions for dividends received from foreign corporations more than 25-per-cent-owned by the recipient Canadian corporation, and carrying on bona fide active business operations in the foreign country. Other provisions patterned generally on the United States law would impose full Canadian taxes on corporate income accruing in "tax-haven" operations. Various other detailed safeguards would be introduced to keep to a minimum the use of non-resident corporations to reduce Canadian taxes of Canadian residents.	(2) The adverse results which would flow because of a foreign country's requirements as to the manner in which a Canadian organization operates in that foreign country.	

Name

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	6.11 The system by which the government proposes to attain its objectives is set out in the following paragraphs. These paragraphs deal successively with dividends from controlled foreign corporations, passive income of controlled foreign corporations, other foreign investment income, business profits and salaries and wages earned abroad by Canadians, and a new procedure for giving shareholders of Canadian corporations credit for the foreign withholding taxes paid by their corporations. 6.12 Most developed countries use one of two general systems to provide that their corporations do not bear unduly heavy income taxes if they carry on business abroad through subsidiary corporations. One system, which is used by most European countries, exempts the dividends received by a resident corporation from foreign corporations which it controls. The present Canadian provisions fall in this general category. The rationale of this system may be over-simplified as "if a corporation tax should be collected, the country in which the profits are earned will collect it, and any further corporate tax collected by the country in which the holding corporation is located would be 'double taxation' and a fiscal barrier to international investment."		

Name

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	6.17 A dividend from a Canadian-controlled foreign corporation not protected by tax treaty would be subject to a tax-credit regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underlying business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available. 6.18 The existing dividend exemption system would be retained for several years, at least througl 1973, as a transitional measure until an appropriate network of international tax treaties can be built up.		

Name

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	6.19 Subject to the limitation noted below, the general capital gains provisions would apply to the shares of controlled foreign corporations—gains realized on the disposal of them would be fully taxable and losses fully deductible (except of course to the extent that the gain or loss accrue prior to valuation day). However, because full corporate tax would not be collected on dividends from such corporations it would be necessary to place a limit on the deductibility of losses if the system as a whole is to be effective. Otherwise, Canadian corporations could purchase control of foreign corporations, arrange to receive most of the assets of the company as a special dividend, and then sell the shares for the value of the remaining assets. The dividend would bear little or no Canadian tax because of the foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax. This tax result is clearly inappropriate since the Canadian corporation would not, in fact, have suffered an over-all loss on its investment. To avoid this consequence, it is proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation tax.		

Name

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	6.20 As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely. 6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.		

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	6.23 The present tax treatment of the business profits and wages earned abroad by Canadian corporations or individuals is the same as that for portfolio investment income. The income is taxed as earned, and the taxpayer is entitled to a foreign tax credit for taxes paid to the government of the foreign country on that income. The government proposes to continue that treatment. 6.24 While the government proposes to retain the existing system of taxing foreign business profits, two important changes to the foreign tax-credit provisions are appropriate. Provisions will be put forward to prevent taxpayers from reducing Canadian tax by transferring the operation of a foreign branch which has sustained losses to a foreign company in order to avoid the Canadian tax which should ordinarily be recaptured on subsequent branch profits. 6.25 In addition, the government proposes to amend the foreign tax-credit provisions to permit the excess of foreign taxes paid over the amount creditable in a year to qualify for allowance in other years. The carry-over of the foreign tax credit is intended to alleviate the problem that arises when income is taxable abroad in a different year from that in which it is taxable in Canada.	

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	6.26 In its tax treaties, Canada will also be prepared to recognize the income taxes levied by political subdivisions of foreign countries on a reciprocal basis. If the foreign country is prepared to give a foreign tax credit for the income taxes levied by the provinces, Canada will agree to give a credit or a deduction, whichever is appropriate, for the taxes levied by its political subdivisions.	

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Pension Plans

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Pages 13 and 14 of the Brief The Brief submits that the 10% limit of pension fund assets in foreign securities could be injurious to Pension Funds.

Name: THE STEEL COMPANY OF CANADA LIMITED

Number Assigned:

Date Brief Received:

Date Brief Heard:

Principal Subject: Income Averaging

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
The Income Tax Act does not permit the average of income.	2.53 Income tax is levied on a year's income at a time, at a rate that normally depends on the size of that year's income alone. But some types of income are irregular, and tax must be paid at a higher rate in a year when income is abnormally high. This may cause taxpayers with irregular or varying incomes to pay significantly higher taxes over a series of years than those whose incomes are more regular. Special provisions in the existing law permit farmers and fishermen to average their incomes over a block of five years, authors over three years, and businessmen on certain unusual types of income over three or five years. Certain types of single payments out of pension funds, or by employers on retirement of an employee, can be taxed at the average rate of tax paid by the employee over the preceding three years.	Pages 14 and 15 of the Brief The Brief supports the proposal of income averaging; but believes the method proposed to be inadequate. The Brief submits that if the proposal to average is adopted, serious consideration should be given to retaining the present provisions of Section 36 of the Income Tax Act.	

Name:

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	2.54 The introduction of a capital gains tax, particularly one in which accrued gains on shares in widely-held Canadian corporations are taxed periodically, would increase the need for a more general averaging formula, because many more taxpayers will occasionally have incomes much higher than their average incomes. The royal commission noted this need under a capital gains tax and recommended for all taxpayers an averaging formula similar to that now available to farmers. It also recommended that "deposit averaging" be permitted, under which a taxpayer could deposit with the government a portion of his income—on an interest-free basis—and pay no tax on it until it was withdrawn.		

Name:

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	2.55 The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need for keeping records. Moreover, the system proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes.		

Name:

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.		
	2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level".		

Name:

Date Brief Received:

Principal Subject:

Number Assigned:

Date Brief Heard:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief	Comments
	2.59 A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependants' deductions have been granted. It is therefore proposed that a married person may use for averaging only an unbroken series of years after		

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Entertainment and Related Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act permits the deduction from income of reasonable amounts of business promotion expenses. Section 12-2 of the Income Tax Act permits the tax collector to restrict claims for unreasonably large amounts of expenses.	*Entertainment and Related Expenses* 5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars. 5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.	Page 15 of the Brief Entertainment and Related Expense: The Company is not in agreement with the proposal to disallow these expenses, which in most cases are necessarily incurred to earn income. We see no reason for the statement that legitimate business expenses should be met from tax-paid income. The existing legislation contains adequate safeguards to prevent abuse, and we believe that the present staff of the Department of National Revenue is fully capable of coping with the problem.

Name: THE STEEL COMPANY OF CANADA LIMITED

Principal Subject: Capital Cost Allowances

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Under the present Income Tax Act, taxpayers are permitted to claim annual capital cost allowances in respect of depreciable property owned by him.	5.14 The system has without doubt proven easy to comply with, and has caused far fewer difficulties between taxpayer and taxgatherer than the more usual "straight-line" system that preceded it in 1948 and earlier years. One of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side. This generosity has acted as an incentive to taxpayers to modernize and improve their business facilities, but naturally at some cost in government revenue. The royal commission did not recommend reductions in depreciation rates. Perhaps for that reason, the rates were not generally an issue in the public debate on tax reform that has taken place over the past two years. Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered. Therefore, the government intends in due course to invite briefs on the system and rates of capital cost allowance.	Page 15 of the Brief This portion of the Brief merely refers to the statement contained in the White Paper that the Government believes the present system of capital cost allowances should be reviewed. The Brief makes the point that any significant change in the simple and effective system should not be contemplated without very careful consideration of its economic impact.

APPENDIX "E"

SUBMISSION TO THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

on

THE WHITE PAPER PROPOSALS FOR TAX REFORM

DOMINION FOUNDRIES and STEEL, LIMITED

HAMILTON, ONTARIO

SUMMARY

Our brief makes the following points:

1. We commend the federal government for putting out the White Paper and agree with its basic objectives.

2. Some of the objectives of the White Paper will make it impossible to meet the other objectives of economic growth and widespread understanding.

3. We challenge the need for continually increasing government expenditures.

4. We approve of the proposal that would reduce the tax burden on low-income groups.

5. We suggest an alternative to the White Paper proposals for the integration of corporate and personal income taxes.

6. We express our concern about the economic effects of reducing savings.

7. We suggest that current incentives for iron ore mining be maintained.

8. We point out the harmful effect on our employees of the proposed changes in the taxation of retirement saving plans and recommend an alternative.

9. We take issue with the following proposals:

a) The taxation of unrealized capital gains.

b) The taxation of entertainment and related expenses.

c) Higher taxes for middle-income groups.

d) Tax on sales of personal residences.

e) The transitional period for the reduction of the top income tax rate.

10. We contend that all federal and provincial taxes should be taken into consideration before any federal tax reform is undertaken.

11. We contend that the percentage of the gross national product spent by governments is already too high and that such forfeiture of individual freedom hinders the common good instead of promoting it.

We feel privileged, as Canadian citizens and as representatives of Dominion Foundries and Steel, Limited, to have the opportunity to participate in the debate on the White Paper on Taxation. The initiative and courage displayed by the federal government in inviting the general public to comment on so complex and controversial a matter as taxation are most commendable.

The suggestions put forth in the White Paper are clearly an effort to attain certain specific objectives. These include "a fair distribution of the tax burden based upon
(ref. 1.6) ability to pay; steady economic growth and continuing prosperity; recognition of modern social needs; widespread understanding of and voluntary compliance with tax laws, combined with enough detail to block loopholes; and, finally, a system that can and will be used by the provinces as well as Canada". These are worthwhile objectives and we are in general agreement with them.

Our brief, therefore, is based not on whether or not the objectives are valid, but on whether or not the proposals put forth in the White Paper will, in our opinion, meet these objectives.

Our general contention is that the methods proposed for meeting some of the objectives will negate the possibility of meeting the others. This is particularly true in the

(ref. 1.10) area of "steady economic growth and continuing prosperity" and "widespread understanding of and voluntary compliance with tax laws". Furthermore, we challenge the validity of one of the premises of the report which states that the (ref. 1.3) "needs of the federal and provincial governments for money to do useful and important things are so great that we cannot now afford to reduce the over-all revenues from personal and corporate income tax."

Our brief will, therefore, be based on these points while keeping in mind our basic agreement with the over-all objectives.

Several ideas are put forth in the White Paper which would, in our view, be beneficial in improving the economic welfare of Canadians. They should be implemented.

TAX RELIEF

(ref. 2.4)

- Tax relief for low-income Canadians is, of course, desirable. The proposed increase in the basic personal income tax exemption is one method of achieving this goal.

CHILD CARE EXPENSES

(ref. 2.7 to 2.9)

- The provision which would permit tax deductions for child care for working mothers would probably favour a more efficient use of human resources.

THE "NOTHINGS"

(ref. 5.4 to 5.8)

- The proposal to permit companies to deduct capital expenditures which are not presently deductible, such as plans for projects that do not materialize, would present a more realistic approach to deducting, for tax purposes, legitimate business expenses.

TAXATION OF SHAREHOLDERS

(ref. 4.19 to 4.45)

- The White Paper proposes an inducement for Canadians to invest in Canadian business. The method proposed to achieve this goal is not practicable because:

  a) The suggested system of integration is so complex that many company Directors will find it difficult to understand, let alone the average shareholder.

  b) Under the suggested system there could well be a conflict between tax planning and what would otherwise be appropriate business policy with respect to dividends. The introduction of stock dividends strikes us as being artificial.

  c) The proposed 2-1/2-year period in which dividends must be paid would create great administrative difficulties.

d) Integration would reduce the effectiveness of tax incentives.

We suggest that the objective of encouraging investment in Canadian companies could better be achieved simply by increasing the present dividend tax credit to an appropriate percentage, possibly 30%. It would also make the taxation system easier to understand.

Dividends between taxable Canadian corporations should continue to be exempt of tax to the recipient corporation.

We know that the implementation of the above mentioned proposals may cause a reduction in revenue. It seems that increasing the tax burden on other groups was viewed by the authors of the White Paper as the only solution to that problem. We suggest that solving it by curbing government expenditures should be viewed as a viable alternative. All government expenditures should be reviewed, with a view to maintaining only those programmes which are essential and meet the needs of today's society. Also, all political parties should refrain from recommending additional expenditures for the sake of political expediency. The business community would be pleased to provide personnel who could make specific suggestions on how government expenditures might be cut back.

(ref. 8.41) We are also concerned about the possible economic effects of reducing savings. The eventual reduction is estimated in the White Paper to be $525 million. It is not unreasonable to speculate that it might make industrial expansion and, therefore, the creation of jobs more difficult. Its possible effects on consumer credit and inflation are also a cause for concern.

There are a number of proposals in the White Paper with which we disagree. Our comments will be based partially on their effect on the interests of our Company, but also on what we think their effect will be on the over-all economic welfare of Canada.

We would, therefore, like to point out how the specific proposals would be harmful.

MINING AND PETROLEUM

(ref. 5.23 to 5.44)

- The proposed changes regarding income tax treatment of income from mining would be a deterrent to developing Canadian iron ore mines. Our Company presently receives most of its iron ore from Canadian sources which it has helped to develop. However, should the proposed changes be implemented, Dofasco would be forced to look to other countries also to meet its future iron ore requirements. Canada would not be well served by the implementation of this proposal, especially

when one considers that no additional revenue is indicated as a result of the change. We know that if the present income tax treatment is retained, it would make a major contribution towards fostering regional development which is an important government objective. In our view, private capital could play a vital role in helping the federal government meet this important objective.

We will deal with this aspect of the White Paper in greater depth in a joint presentation with other steel companies.

RETIREMENT SAVINGS PLANS

(ref. 2.45 to 2.59) - The White Paper proposals regarding payments made from deferred profit sharing or pension plans, would have a very harmful effect on Dofasco's 7,200 employees and their widows. Our Company is very proud of the international reputation it has acquired as a leader in the field of employee-employer relations. This harmonious relationship has played a major role in making Dofasco one of the most productive steel mills on the North American continent. The fact that we share our profits with our employees contributes greatly to this relationship. We have both a pension plan

and a deferred pension plan based on profit sharing. The pension plan was established in 1938.

Employees have been and are permitted to take the proceeds from their profit sharing fund by annuities. They may also take it in cash in order that they may provide for their retirement security in other ways. This freedom of choice is one of the fundamental benefits of profit sharing. Yet, it would effectively be destroyed should the new proposal be implemented because of the greatly increased tax rate.

For example, a $9,000-a-year man, retiring with a sum of $45,000 available to him would, under the present averaging system, pay about $8,300 or 18% on the lump sum. Under the proposed rates and averaging system, he could pay up to $15,800 or a staggering 35%, depending on the time of the year when he would retire. (See detailed calculation on page 14.)

Actuaries have indicated to us that the current effective rates on cash payout nets the government approximately the same revenue from the average retiree as would taxing the resultant annuities.

Perhaps one of the reasons for putting forth this White Paper proposal is to help curb abuse in

certain areas. We believe these abuses could be controlled by other methods, such as the imposition of a limit on the amount per year of service that could be collected from a pension or deferred profit sharing fund. Another possible method would be to impose a minimum on the number of participants in such a plan.

RECOMMENDED ALTERNATIVE

- As far as the taxation of retirement benefits is concerned, we suggest that a flat rate of 15% could be charged on retirement, whether the money is taken in lump sum or used for the purchase of an annuity. There would, of course, under this system be no tax on the receipt of annuity payments.

ENTERTAINMENT AND RELATED EXPENSES

(ref. 5.9 and 5.10)

- The White Paper is so written as to give the reader the impression that inequity is rampant and that tax evasion by the "well-to-do" is so widespread as to force "major structural reform".

  We are convinced that the vast majority of business people are honest and that the present system of tax enforcement can deal adequately with the problems of abuse. We, therefore, contend that the proposal to disallow all entertainment

and related expenses is an unreasonable way of dealing with these problems.

Furthermore, the proposed changes would put Canadian companies at a serious disadvantage when competing with foreign companies who can write off lavish entertainment expenses.

ADDITIONAL ELEMENTS OF INCOME TO BE SUBJECT TO TAX

(ref. 2.22 to 2.27) - Workmen's Compensation payments are not taxable as income, either under the present system or, as we understand it, under the proposed system. We suggest that income from such benefits as disability insurance be treated in the same manner.

TAXING UNREALIZED GAINS

(ref. 4.19 to 4.45) - The proposal to tax unrealized capital gains in shares of widely-held Canadian companies every five years is nothing short of confiscatory. This could result in a shareholder being forced to sell stock to pay the tax on it as well as cause company owners to lose control of the company they worked hard to establish. In addition, it would make it more difficult for Canadian companies to raise capital by selling shares.

The proposal should be abandoned.

We suggest that, if it is felt necessary to introduce a capital gains tax, it should not be more onerous than in the U.S., where only realized gains are taxed.

PRINCIPAL RESIDENCES

(ref. 3.19 to 3.21) - We suggest that capital gains tax on the residences and miscellaneous personal property of the taxpayer not be imposed. They might be imposed, however, on the sale of securities or real estate investments other than the residences used by the taxpayer in question.

EFFECTS ON MIDDLE-INCOME TAXPAYERS

(ref. 1.22 to 1.26) - The proposals of the White Paper would have the effect of increasing the already heavy burden of taxation on middle management and staff executives. Because we are in an international business, we occasionally are forced to import from the United States highly trained people. The acquisition of these people would become more difficult since the tax treatment they would receive here would be less favourable than in the United States.

CAPITAL GAINS AS INCOME

(ref. 1.11) - We agree with the proposal that the top marginal rate of personal income tax should be reduced to

the level of corporate income tax. We recommend that this be done immediately upon implementation of the tax proposals instead of over the 5-year period suggested. If, for revenue reasons, this is not possible, the proposed 50% rate should be the maximum used as the basis for taxing capital gains (effective maximum 25%) and investment income during the transition period.

CLOSELY-HELD VERSUS WIDELY-HELD CORPORATIONS

(ref. 4.43 to 4.45)

- In the proposals, important distinctions are made between closely-held corporations and widely-held corporations. These distinctions are over-simplified and arbitrary and cannot be accepted as a basis for tailoring a tax structure. Shareholder and management participation is not confined to closely-held corporations. Some widely-held corporations are actively controlled and managed by small groups of shareholders. Furthermore, these two types of corporations often compete with each other and the proposed new system could give one an unfair advantage over the other.

OTHER TAXES

- It is suggested in the White Paper that several matters be dealt with separately after implementation of the present proposals. These include a review

of sales taxes, which amount to a full 16% of federal revenue (excluding excise taxes), and a review of capital cost allowances. We feel that no tax reform should be undertaken without also dealing with these two important areas.

Tax reform at any level of government should take into account all taxation at all levels.

INVESTMENT INCOME OF CLUBS AND OTHER NON-PROFIT ORGANIZATIONS

(ref. 5.54) - The White Paper proposes that investment income of certain non-profit organizations be taxed in the same manner as corporate income. The report should clarify whether professional associations, labour unions, and others are included in this category.

AGREEMENT WITH PROVINCES

- As a final and vitally important point, we suggest that no major tax reform be undertaken at the federal level without prior agreement with the provinces.

CONCLUSION

We have presented these views in a spirit of constructive criticism and with the desire to cooperate with all levels of government in helping to improve the standard of living of all Canadians. We are concerned not only for the self-

interests of the Corporation we represent, but for the country as a whole. This is why we seriously question whether government should be spending on behalf of the citizens, such a high percentage of our gross national product. We accept the fact that the individual citizen has to give up some of his freedom for the common good. We are convinced, however, that if too much freedom is forfeited, the common good is no longer served. We have reached that point. The proposals of the White Paper on Taxation which would have the eventual effect of increasing our taxes, would take us beyond that point.

CALCULATION ON INCOME TAX PAYABLE ON A LUMP SUM PAYMENT OUT OF A PENSION PLAN ON THE PRESENT INCOME TAX BASIS AND ON THE BASIS OF THE PROPOSALS IN THE WHITE PAPER

It is assumed that the person receiving the $45,000 lump sum payment had income of $9,000 per year in the four years prior to retirement, that he is married with no other dependents and that he retired January 1. The calculations on the basis of the proposals in the White Paper are after full implementation of the proposals after any transitional period.

Present Income Tax basis

Tax payable for the year on gross income of $9,000 assuming pension plan contributions of $200 per year and Canada Pension Plan of $85., excludes the surtax and the tax reduction		$ 1,570
for 3 years		4,710
Gross income for the 3 year average calculation is $9,000 less pension plan and Canada Pension Plan contributions of $285		8,715
for 3 years		26,145
Average rate of tax $\frac{4,710}{26,145} \times 100 = 18\%$		
Tax payable on the lump sum		
18% of $45,000	$8,100	
plus surtax, 3% of basic tax	243	
Total tax payable		$ 8,343

White Paper basis

The following format is that used in Table 11 on page 34 of the White Paper.

Income calculations:

Average income of 4 years	$ 9,000	
Threshold amount is average income plus 1/3	12,000	
Excess of income in the year $45,000 over threshold amount $12,000	33,000	
Divide this excess by 5	6,600	
Add this 1/5 to the threshold amount	18,600	
Tax on $18,600	5,364	
Tax on threshold amount $12,000	2,749	
Difference is tax on 1/5 of the excess	$ 2,615	
Multiply tax on 1/5 excess by 5 = tax on excess	$13,075	
Tax on threshold amount	2,749	
Total is tax on lump sum payment of $45,000		$15,824

WILLIAM M. MERCER LIMITED
7 KING STREET EAST
TORONTO 1

LAURENCE E. COWARD
EXECUTIVE VICE-PRESIDENT AND DIRECTOR

April 27, 1970.

Mr. T. Van Zuiden,
Treasurer & Assistant Secretary,
Dominion Foundries and Steel, Limited,
P.O.Box 460,
Hamilton, Ontario.

Dear Mr. Van Zuiden,

Taxation of Lump Sums under Section 36

As requested, I am sending you an example illustrating the point made by Ian Smith that taxation of lump sums under Section 36 of the Income Tax Act does not necessarily cause loss of revenue to the government.

We have compared the value of the tax payable on an amount of $40,000:

a) if taken as a single payment taxed under Section 36 and used by the individual to purchase an annuity (which includes a taxable portion) or

b) If taken in the form of an annual pension, all of which is taxable income.

In order to make the comparison it is necessary to make a number of assumptions concerning the individual. We only give one example but we believe it is a fair and typical one. The following are the details.

It is assumed that a married male retires in 1970 at the age of 65. His income for the preceding three years has been:

	Tax Payable under Part 1 of the Act
1967 - 10,000	1,523
1968 - 10,500	1,666
1969 - 11,000	1,815
Total 31,500	5,004

$$\text{Average tax rate} = \frac{5004}{31500} = 15.89\%$$

Additional assumptions made were as follows :

We assumed that the only other income of the taxpayer for 1970 and subsequent years would be his Old Age Security Pension and Canada Pension Plan pension calculated at the full rate.

We assumed that his total deductions from income would be $2,100 each year. No adjustment was made for the fact that his wife might be in receipt of an Old Age Security Pension.

We have assumed that the annuity purchased in all cases will be on a "life-only" basis.

On the basis of the above assumption the calculation under each of the two alternatives is as follows :

Present Value of Tax if $40,000 taken under Section 36

Tax on Single Payment - 15.89% x $40,000 =		$6,356

Tax on interest element if balance of $33,644 is used by individual to purchase an annuity (calculated on the basis of Annuity Table for 1949 at 7% interest) is as follows :

Annual Pension	$ 3,905	
Capital portion of annuity	$ 8,616 / 14,400 = 60%	
Tax on taxable portion	$ 193	
Present Value of Annual Tax		$1,663
Total Tax Payable		$8,019

Present Value of Tax if $40,000 used to provide pension on a tax-sheltered basis.

Amount of Annual Pension	$ 4,643
Total Annual Income including OAS and CPP	$ 6,897
Annual tax on total income	$ 785
Amount of tax payable re CPP and OAS if this had been sole income	$ 17
Annual tax payable in respect of pension	$ 768
Present Value of Tax	$ 6,617

It will be seen that the tax paid under Section 36 is greater in this example than the tax if the individual had elected to take an ordinary annuity.

The calculations are rather involved, but it appears impossible to make a valid comparison without using "present values" of the future taxes as we have done in the example. We could of course work out a range of examples on the same principle, but perhaps the one will be sufficient for your present purpose.

Yours sincerely,

Laurence Coward

Laurence E. Coward
Executive Vice President.

LEC/gh

APPENDIX "F"

NAME: DOMINION FOUNDRIES AND STEEL LIMITED

SUBJECT: White Paper Proposals

Analysis of Appendix "E" by Senior Advisor

This Brief is submitted by Dominion Foundries and Steel Limited a public company owned by some 20,200 shareholders. Residents of Canada own 94.2% of the issued shares of capital stock.

The Brief deals with three primary subjects which are:

1. Taxation of shareholders
   (Pages 3, 4 and 5 of the Brief)
2. Taxation of Mining an petroleum industry
   (Pages 4 and 6 of the Brief)
3. Taxation of Retirement Saving Plan Payments
   (Pages 6, 7, 8, 14 and 15 of the Brief)

In additional the Brief makes observations on a number of other subjects but does not develop them in detail. These are as follows:

1. Agreement with basic objectives of White Paper proposals; comprising:
   (a) A fair distribution of the tax burden based upon the ability to pay.
   (b) Steady economic growth and continuing prosperity.
   (c) Recognition of modern social needs.
   (d) Widespread understanding of and voluntary complian with tax laws, combined with enough detail to block loopholes.
   (e) A system that can and will be used by provinces as well as Canada.
   (Page 1 of the Brief)

2. Approval of those proposals that would

(a) Reduce the tax burden on low income groups. - Tax relief (Page 2 of the Brief) and child care expenses (Page 2 of the Brief)

(b) Permit the deduction of so called "nothings" (Page 3 of the Brief).

3. Criticism of proposals of White Paper respecting

(a) The "unreasonable" proposed manner of dealing with the problem of entertainment and related expenses. (Page 8 of the Brief)

(b) The Proposed taxation of unrealized gains. (Page 9 of the Brief)

(c) The proposed taxation of gains realized on sale of principal residences and personal property. (Page 10 of the Brief)

(d) The increase in the already heavy burden of taxation on middle income tax payers - management and staff executives. (Page 10 of the Brief)

(e) The proposed transitional period to reduce the top rate of tax to 50%. (Pages 10 and 11 of the Brief)

(f) The distinction made between closely held and widely held corporations. (Page 11 of the Brief)

(g) The proposal to implement tax reform, without dealing with all taxation at all levels of government. (Pages 11 and 12 of the Brief)

4. The need for clarification of certain proposals.

(a) Workmens compensation payments:- are these taxable as income? (Page 9 of the Brief)

(b) Professional associations, labour unions and others:- are these organizations classified as clubs and non profit organizations and so subjected to tax upon any investment income received?

(Page 12 of the Brief).

Finally the Brief makes the following points.

1. Some of the objectives of the White Paper will make it impossible to meet the other objectives of economic growth and widespread understanding.

(Point 2 of the Summary of the Brief)

2. We challenge the need for continually increasing government expenditures (Point 3 of the Summary of the Brief)

3. We express our concern about the economic effects of reduced savings. (Point 6 of the Summary of the Brief)

4. We contend that the percentage of the gross national product spent by governments is already too high and that such forfuture of individual freedom hinders the common good instead of promoting it. (Point 11 of the Summary of the Brief)

The Brief suggests that

1. The objective of encouraging investment in Canadian companies could better be achieved by increasing the present tax credit to an appropriate percentage.

Dividends between taxable Canadian corporations should continue to be exempt of tax to the recipient corporation.

(Page 4 of the Brief).

2. The present income tax treatment of income from mining operations, if retained, would make a major contribution towards fostering regional development.

(Page 6 of the Brief).

The current incentives for iron ore mining be maintained

(Point 7 of the Summary to the Brief).

3. A flat rate of 15% could be charged upon the withdrawal on retirement, of funds (whether in a lump sum or used to purchase an annuitee) from a deferred profit sharing or pension plans.

The attention of the Committee is drawn to the following remarks contained in the Brief.

1. Our brief is based not on whether or not the objectives are valid, but on whether or not the proposals put forth in the White Paper will, in our opinion, meet these objectives. (Page 1 of the Brief)

2. We suggest that, if it is felt necessary to introduce a capital gains tax, it should not be more onerous than in the U.S., where only realized gains are taxed. (Page 10 of the Brief).

3. The proposed changes regarding income tax treatment of income from mining would be a deterrent to developing Canadian iron ore mines. (Page 5 of the Brief)

4. Should the proposed changes (in respect to the taxation of mining income) be implemented Dofasco would be forced to look to other countries also to meet its future iron ore requirements. (Page 5 of the Brief).

Name: DOMINION FOUNDRIES AND STEEL LIMITED

Principal Subject: Taxation of Shareholders - Integration.

Present Tax Law	White Paper Proposals	Principal Points of Brief	Comments
	The White Paper proposals relating to integration of tax are contained in Chapter 4 of the White Paper.	Pages 3, 4 and 5 of the Brief The Brief points out the proposal is not practicable because: (1) The suggested system of integration is so complex that many company directors will find it difficult to understand, let alone the average shareholder. (2) There could well be a conflict between tax planning and what would otherwise be appropriate business policy with respect to dividends. The introduction of stock dividends is artificial. (3) The proposed 2 1/2 year period in which dividends must be paid would create great administrative difficulties. (4) Integration would reduce the effectiveness of tax incentives.	

Name: DOMINION FOUNDRIES AND STEEL LIMITED

Principal Subject: Mining and Petroleum

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 5 and 6 of the Brief The Brief points out: (1) The proposed changes would be a deterrent to the development of Canadian iron ore mines. (2) The fact that Dofasco would have to go to other countries to meet its future iron ore requirements. (3) No additional revenue is indicated by the change in tax treatement. (4) The present laws if retained would contribute towards fostering regional development.

Name: DOMINION FOUNDRIES AND STEEL LIMITED

Principal Subject: Retirement Savings Plans

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 6, 7 and 8 of the Brief The Brief points out: (1) The proposals respecting the taxation of payments made from deferred profit sharing or pension plans, would have a very harmful effect on Dofasco's 7,200 employees and their widows. (2) The freedom of choice of employees to take proceeds from profit sharing plan by annuity or other method, one of the fundamental benefits of the plan - would effectively be destroyed. Page 14 and 15 of the Brief The Brief sets out an example of the increased tax which would be payable if the proposals are implemented as compared to the tax payable under the present Income Tax Act.

APPENDIX "G"

Gulf

Proposals For Tax Reform

GULF OIL CANADA LIMITED

MARCH 1970

SUMMARY OF PROPOSALS FOR TAX REFORM

Gulf Oil Canada Limited summarizes below the main points included in the attached brief to the government in response to the request for comments and suggestions on the White Paper on Tax Reform.

1. Welcomes the chance to make its suggestions and believes any redistribution of tax burden should be based on fairness, maintenance of adequate incentives and simplicity.

2. Considers proposals for depletion allowances to be insufficient to attract proper level of exploration and development and proposes a more satisfactory basis by broadening the "eligible" base and changing the formula to 20% of gross income limited to 50% of eligible expenditures. Proposes a transitional period for non-operators' depletion allowance.

3. Proposes simpler and more equitable basis for integrating dividend and personal income by either gross-up and credit of 50% regardless of creditable tax or preferably continuing tax credits at 25% or on a variable tax credit basis. Intercorporate dividends would be exempt from tax.

If this not acceptable, suggests changes to White Paper proposals to put creditable tax on an annual basis, provide a reasonable transitional period and permit creditable tax to be allowed on tax-free incentive allowances and grants together with extension of the period during which creditable tax can be used from 2½ to 5 years.

4. Proposes that no distinction should be made between closely-held and widely-held companies. Both should be handled for dividends as outlined in 3 above.

5. Recommends that the partnership option should be available to companies that qualify, whether closely-held or widely-held.

6. Proposes that for capital gains taxation, a maximum of half of realized gains

or losses be taken into income (with suggestion for lower rates as being more appropriate) on all applicable assets including shares of all companies. No deemed gains should be recognized. Principal residences, owner occupied farms and depreciable personal property should not be subject to capital gains treatment, or if this is not accepted, be subject to unlimited roll-over with a lifetime exemption of gains of $25,000 or $50,000. Gifts and bequests to charitable or educational recipients should be exempted. Valuation options should be permitted of the greater of cost or value on "valuation day". Independent appraisals should be binding and appraisal costs deductible. Non-resident capital gains proposals should be reviewed since reciprocal action will likely result. Liberal income averaging, greater than proposed, should be allowed. Estate taxes (and provincial succession duties) should be reviewed and modified with introduction of capital gains.

7. Welcomes write-off of "nothings" and suggests minor improvements together with recommendation that goodwill not be included.

8. Requests clarification to ensure that tax treatment of rental buildings and holding of property does not apply to industrial operations.

9. Suggests that abuse of entertainment and similar costs can be adequately controlled through present regulations. If this is not acceptable, suggests guidelines similar to U.S. Internal Revenue Code Section 274.

10. Points out that mining and petroleum are quite different and should be considered separately for type and adequacy of incentives.

11. Concurs with a single corporate tax rate but proposes that relieving provisions should be made for small businesses whether or not incorporated. Partnership option should be available under reasonable conditions.

12. Believes that desirable mobility of employees to leave Canada for training and experience should be encouraged and the deemed realization at time of departure eliminated.

13. Recommends that tax barriers should not be placed in way of normal commercial consolidations and amalgamations.

14. Strongly urges that simplicity, certainty and administrative fairness be the keynotes and points out areas which should be improved.

PROPOSALS FOR TAX REFORM

Gulf Oil Canada Limited welcomes the opportunity to present its opinions and suggestions on the proposals in the White Paper on Tax Reform presented by the government on November 7, 1969.

The redistribution of taxation to create a fairer system based on ability to pay must also, in a fast developing economy like Canada's, provide for maintenance of incentives to attract the capital required to produce the maximum economic level of dynamic growth. These principles, probably the most important of the stated aims of the White Paper proposals, are whole-heartedly supported by Gulf Canada. Whether or not the government's proposals accomplish these objectives depends on the incidence of the burden of taxation. It is to this tax burden that Gulf Canada will address its comments and will try to offer constructive alternatives where it believes improper or insufficient emphasis has been placed.

Before commenting on any proposal, Gulf Canada would like to briefly comment on its opinion as to the redistribution of tax burden. It believes that the application of tax revisions should accomplish:

(a) **Fairer taxation**—Relief to low income groups and, subject to recognizing the need to continue adequate growth incentives, reasonable equality of taxation for taxpayers on the same level. Fairness or ability to pay implies taxation at the time of realization and not otherwise. Loopholes which permit incomes, which otherwise should attract tax, to be unfairly relieved should be closed.

(b) **Maintenance of incentives**—Canada's economy is dependent for future growth on proper and adequate incentives to remain competitive and attract the risk capital required to develop its resources. Any plan that does not accomplish this objective will in the long run be detrimental to growth and capital formation.

(c) **Simplicity**—This is a prime requisite of a tax system and since the Canadian

way requires self assessment it is vital that the system be understandable and create the minimum of administrative difficulty for both the taxpayer and the tax collector. Intricate and involved reporting requirements invite misunderstanding.

Initially the White Paper appeared to be a readable and comprehensive set of principles, but the attempt to apply these to actual situations revealed complicated and far reaching consequences which required evaluation in depth to arrive at conclusions as to their effect. Based on the information presently available to us we have reached certain opinions which may have to be modified if further interpretations or revisions change the basic proposals on which these are based.

Gulf Canada, although concerned with the economic impact of some of the other proposals in the White Paper, will primarily restrict its discussion and recommendations to those areas directly impinging on its operations on which it feels most competent to comment.

The main concern of Gulf Canada is in the following specific areas, each of which will be dealt with individually:

(1) Depletion allowances to operators of oil and gas wells

(2) Integration of corporate dividends with shareholders' incomes

(3) Capital gains including revaluation of shares in widely-held Canadian corporations

(4) Certain areas of business income.

We will also include general comments with reference to some of the other proposals contained in the White Paper, which we believe should be re-examined as to their ultimate effect on Canada's economy.

Before passing to the formal part of the brief, Gulf Canada wishes to comment briefly on the government's intention, as stated in the White Paper, to review the system and rates of capital cost allowance and solicit views thereon from business and

the public generally before major changes are considered. If this implies that the government intends to revise the capital cost allowance system, it is unfair to ask corporate taxpayers to give meaningful consideration to tax reform proposals without some knowledge of possible changes to this important area. The burden of taxation cannot be properly assessed when such possibilities exist and this applies also to any ultimate revision of the Excise Tax Act.

PROPOSALS FOR DEPLETION ALLOWANCES — OIL AND GAS

DEPLETION ALLOWANCES TO OPERATORS OF OIL AND GAS WELLS

Present Basis

Exploration and certain development expenditures, whether capitalized or expensed, can be written off for tax purposes against taxable income in the year incurred. These expenditures include acquisition costs, exploratory and development drilling (including casing but excluding other tangible well equipment) and associated costs. This group of costs is hereafter referred to as 83A costs (the section of the Income Tax Act which presently authorizes their deduction).

A depletion allowance is permitted equal to one-third of net depletable production profits after deducting 83A costs. This allowance is deductible from net depletable production earnings and hence is only granted if there are sufficient production earnings. Income tax regulation changes, made effective January 1, 1969, require calculation of depletion allowances on a group basis for associated companies.

It should be noted that under present rules, with a constant income, the higher the level of 83A costs, the lower the depletable base and the depletion allowance.

White Paper Proposals

The White Paper on Tax Reform adopts a new approach in that it proposes an allowance calculated as a proportion of certain exploration and development expenditures. Specifically the proposal is to allow depletion to be "earned" on the basis of \$1 "earned" for every \$3 of "eligible" expenditure with the overall existing limit of one-third of net production profits applying.

Eligible expenditures would remain as presently defined as 83A costs except that acquisition costs of mineral rights would **not** be included as "eligible".

A transitional period is proposed which provides:

(a) that depletion allowances on the present basis (one-third of net depletable

profits after 83A costs deducted) will continue for five years after implementation day without having to be "earned";

and in addition

(b) that during the period after November 7, 1969 (date of issue of the White Paper) to the end of five years after implementation day "earned" allowances will be accumulated at the rate of $1 for every $3 of eligible expenditures.

The accumulation or "bank" would be built up during the transitional period available for use after the transitional period to supplement, until exhausted, any short fall in the allowance below that obtainable under present rules. Any one year's allowance would continue to be limited to one-third of net production profits after all 83A deductions including the "ineligible" costs of acquisition of mineral rights.

In 1963 Gulf Canada together with the rest of the industry submitted briefs to the Royal Commission on Taxation and in 1967, following the issuance of the report of that Commission, submitted to the Minister of Finance further arguments relative to the Commission's findings. These arguments centred primarily around the vital necessity of retaining incentives for the petroleum industry and criticism of the existing allowance system which it contended was not on an efficient basis. Gulf Canada and the industry generally submitted that an allowance based on gross production income was the best method of accomplishing the necessary incentive and would avoid the inefficiency occasioned by the existing allowance based on net profits where the higher the level of expenditure on exploration and development, the lower the amount of allowance.

It is reassuring to see that the government has recognized that the tax system should continue to contain incentive allowances to oil and gas producers and in addition, has made proposals to correct the inefficient nature of the existing allowance.

Comments on White Paper Proposals

In order to examine the effect of the White Paper proposals it is necessary to consider these apart from the transitional period. What is contemplated is a complete reversal of the existing basis of allowance as can be shown by the following figures:

Gross Depletable Income (after Royalties)	Operating Expenses	Profit Before Eligible Expend.	Eligible Expend.	Net Production Profits after Elig. Exp.	Depletion Allowance		White Paper Proposals	
					Present Basis	White Paper	Useable	Defer
100	20	80	0	80	26.7	0	0	—
100	20	80	10	70	23.3	3.3	3.3	—
100	20	80	20	60	20.0	6.7	6.7	—
100	20	80	30	50	16.7	10.0	10.0	—
100	20	80	40	40	13.3	13.3	13.3	—
100	20	80	50	30	10.0	16.7	10.0	6.7
100	20	80	60	20	6.7	20.0	6.7	13.3
100	20	80	70	10	3.3	23.3	3.3	20.0
100	20	80	80	0	0	26.7	0	26.7

It should be noted that the present and proposed methods break-even when eligible expenditures are half of the profit before eligible expenditures. Because of the limitation that the allowance must not, in any one year, exceed the present basis, any expenditures above this level will not earn allowances in the year incurred but the difference can be carried forward for future use.

It could be argued that proven reserves of oil and gas on hand at the date of implementation of the new system were based on tax rules which permitted a deduction from profits for depletion allowances under present law. If the consequent liquidation of such reserves is made less economic by a change in tax rules, this is retroactive taxation and is inequitable. The government, in an apparent attempt to offset this argument, has proposed transitional rules which result in deferring any adverse effect for a number of years for the more mature companies presently receiving depletion allowances.

However, this does not in itself make up for the proposed change in tax rules and will result in higher taxation of income from discoveries made prior to implementation of the new system. Hence any new tax system should give recognition to this factor by a more generous basis of rates during and after the transitional period.

The White Paper acknowledges the high risk involved in searching for and developing oil and gas resources and the fact that without an adequate incentive it will be most difficult to attract the necessary capital or justify rates of return necessary to continue a high level of exploration and subsequent development.

Therefore, while recognizing and agreeing with the White Paper concept of tying allowances to work performed, Gulf Canada contends that the proposed basis is, by itself, inadequate to continue to attract the proper capital inflow and attain the desired level of exploration and development activity.

Depletion allowances are only permitted as a deduction from production net earnings after exploration and development costs. Many producing companies in Canada have never had a depletion allowance (and many never will) so that total expenditure on eligible costs for the industry is not indicative of a base for granting depletion allowances. However, among those who have been receiving depletion allowances are most of the larger companies who dedicate a large proportion of their resources to continuing exploration and development activities and who have access to the larger financial resources which will be required as emphasis shifts to the higher cost areas of the Canadian Arctic and offshore plays.

Because of the international nature of many of these larger companies, they are extremely sensitive to adverse economic factors that might reduce the rates of return below those obtainable in other competing countries and it is vital to Canada that a favourable climate be provided to encourage maximum investment in natural resource development.

Specific Changes to White Paper Proposals

There are two areas which, in our opinion, require revision:

(1) broadening the base of the "eligible" expenditures on which the allowance is to be calculated

(2) changing the method of application to provide a more efficient basis of annual allowances.

(1) BROADENING THE BASE OF ELIGIBLE EXPENDITURES

There are certain essential exploration and development expenditures which are excluded by the White Paper proposals as being "eligible" to earn depletion, but which in our view should be included. These are:

(a) Certain acquisition costs of mineral rights

(b) Well and associated equipment

(c) Gas plant capital facilities

(a) **Certain Acquisition Costs of Mineral Rights**

The present 83A costs include acquisition of mineral rights and the White Paper proposes that they continue to be fully deductible for tax purposes in the year incurred. However, it also proposes that they will not be included as "eligible" expenditures and no allowance will be granted on their cost. The Finance Department stated that the inclusion of such acquisition costs could, in their opinion, result in manipulation between companies (selling and buying in alternate years) to increase their "earned" depletion. While this could be possible, it could not apply to acquisition costs of mineral rights directly from the Crown (provinces and federal government) and we see no reason why, at least to this extent, that the inclusion of this primary exploration cost should not be allowed as an "eligible" expenditure.

(b) **Well and Associated Equipment**

Under present rules these tangible assests (well head equipment, flow lines, tank batteries etc.) are depreciable and are excluded from the 83A costs that are fully

deductible in any one year. There is, however, no question but that these are necessary costs in developing oil and gas reserves. Hence we believe these should be allowed as "eligible" expenditures for the sole purpose of determining depletion allowances.

(c) **Gas Plant Facilities**

Gas Plant expenditures should be considered as "eligible" expenditures because they are an integral part of any development program. Specifically, the following two points are made:

(a) in most situations the gas as produced at the wellhead is not a saleable product and, therefore, at the gas plant the gas must be separated from certain components to bring the gas up to the standard set by the gas transmission company.

(b) many gas plants are constructed due to governmental orders requiring the conservation of gas that is produced in association with oil. The return on such conservation projects is, therefore, contingent upon the economics of the oil production because the oil cannot be produced unless the gas is conserved. The plant is obviously an integral part of the development program.

The White Paper proposes that mining machinery and buildings should be included in a separate class and taxpayers should be permitted to write-off the investment just as fast as the new mine generates enough income to absorb the charge. This proposal is based on the reasoning that "mining corporations spend large sums of money on mining machinery and buildings before they know whether their new mine will be profitable". In addition to this accelerated capital write-off, and of more immediate interest to Gulf Canada, however, is the fact the White Paper proposes that such investment would be classified as "eligible" expenditures for the earning of depletion allowances.

In regard to the petroleum industry, the risk inherent with gas plant expenditures

is, in many respects, similar to that described above for mining corporations. Specifically some of these risks may be summarized briefly as follows:

(a) the size, nature and performance of gas reservoirs is extremely difficult to estimate. This is partly due to the fact that because of the high cost of drilling additional wells, reserves must be based on estimates derived from wells usually spaced a mile or more from each other. As a result, the major investments for gas plant facilities are made at a time when there is great uncertainty as to the quantity and recoverability of the gas reserves involved.

(b) the properties of gas vary greatly from reservoir to reservoir and thus each plant is designed to meet the specific conditions existing at each location. This specialized equipment is often not adaptable for use at other plants and, therefore, there is little likelihood of recovery by way of salvage. Additionally, the cost of dismantling the equipment and the significant transportation costs, usually from very remote areas, add to this problem. The transportation of corrosive raw gas beyond 15 or 20 miles to utilize existing facilities is usually not feasible due to the economics and safety factors involved.

Therefore, it is Gulf Canada's opinion that from the strictly risk point of view gas plants should be considered as eligible expenditures for the earning of depletion allowances.

Gulf Canada therefore proposes that, in the light of the arguments put forth above, capital expenditures for gas plant construction should be included in the definition of "eligible" expenditures.

(2) CHANGING THE METHOD OF APPLICATION

The White Paper proposes a depletion allowance which relates to work performed at the rate of $1 of allowance for $3 of eligible expenditures but restricts the allowance, in any one year, to one-third of **net** production profits after deducting exploration and development expenditures. This restriction continues the inefficiency

(that has been acknowledged by both the industry and the government) of substantially reducing allowances as higher expenditure levels are reached. While recognition is given to allowing unused portions of earned depletion allowances to be carried forward, deferment can be for an indefinite period when the work performed continues at a level higher than the break-even point (where expenditures are half of the profit before eligible expenditures). In the long term, under the White Paper proposals, allowances cannot exceed one-third of net production profits but will be substantially less.

It must be kept in mind that no allowance is permitted except as a deduction from taxable income and that the government only allows depletion when successful production generates sufficient income to permit its deduction. This is the government's major control on depletion allowances.

A substantial reduction in allowances from the present basis (one-third of net production profits) could only result in a lower level of available reinvestment funds and would work against the government's expressed desire for an efficient incentive to encourage a continuation of a satisfactory level of exploration and development activities.

Therefore, Gulf Canada believes that revisions are necessary to the formula proposed in the White Paper and that such revisions should accomplish the two objectives of:

(a) Correcting the present inefficiency arising from continuing to use the "net" basis as a limit, which results, in any one year, in reducing allowances as eligible expenditures increase. This can be corrected by using gross depletable income (after royalties) as a base and applying a lower (but generally equivalent) percentage of 20% of "gross" depletable income instead of 33⅓% of "net" production profits;

and

(b) Adjusting the rate of "earning" depletion allowances to a more reasonable level than the White Paper proposal of one-third of eligible expenditures which results in the situation that (at the point at which the maximum allowance is reached in any one year) the eligible expenditures are 1½ times the net cash flow after taxes (net

production profits less taxes payable). This can be shown by the table below where this maximum point occurs when eligible expenditures are 40% of gross depletable income as compared to the net cash flow after taxes of 26.7% of gross depletable income (net production profit of 40% less taxes of 13.3%). This result is unrealistic over a long period in terms of available funds which will be insufficient to accomplish the objective of maintaining a satisfactory level of exploration and development activity.

Gulf Canada believes that a more satisfactory basis would result from modestly changing the rate of allowance from one-third of eligible expenditures to one-half. At this proposed rate, the eligible expenditures would equal the net cash flow at the level of 32% of gross depletable income.

Proposal

Gulf Canada therefore proposes that depletion allowances be computed on the basis of **20% of gross depletable income** (**after deducting royalties**) **limited to 50% of eligible expenditures.**

Such an allowance would compare as follows:

Comparison of Allowances and Taxes Payable

Gross Depletable Income (after Royalties)	Operating Expenses	Profit Before Eligible Expend.	Eligible Expend.	Net Production Profit	Annual Allowances			Taxes Payable at 50% Rate		
					Present Basis	White Paper	Gulf Proposal	Present Basis	White Paper	Gulf Proposal
100	20	80	0	80	26.7	0	0	26.7	40.0	40.0
100	20	80	10	70	23.3	3.3	5.0	23.3	33.3	32.5
100	20	80	20	60	20.0	6.7	10.0	20.0	26.7	25.0
100	20	80	30	50	16.7	10.0	15.0	16.7	20.0	17.5
100	20	80	40	40	13.3	13.3	20.0	13.3	13.3	10.0
100	20	80	50	30	10.0	10.0*	20.0	10.0	10.0	5.0
100	20	80	60	20	6.7	6.7*	20.0	6.7	6.7	0
100	20	80	70	10	3.3	3.3*	10.0*	3.3	3.3	0
100	20	80	80	0	0	0*	0*	0	0	0

*Proposed Limits have been applied to indicate annual effect

Gulf Canada's proposed formula has the following advantages compared to that in the White Paper —

(1) It is based on "gross" income and does not reduce with increased levels of expenditure. This effectively removes the inefficiency built into the "net" basis.

(2) It is simple and easy to compute.

(3) It is work oriented with the allowance directly related to work performed. While it levels out when expenditures exceed 40% of gross income there is no decline in allowances until an insufficient level of profit is reached.

(4) It is only moderately greater than the allowance incorporated in the White Paper and, at most levels, is substantially less than the present basis.

(5) It is expressed in terms (gross) which are competitive with U.S.A. basis and industry practice.

Carry-Over Provision

The White Paper proposals permit carry-forward of unusable portions of allowances which cannot be deducted in any one year. Similarly it is proposed that the same principle apply to Gulf's formula and if 50% of eligible expenditures exceeds 20% of gross depletable income, the balance could be carried forward. Similarly if any limitation arises due to an insufficient level of available taxable income any undeducted amount could be carried forward.

Proposed Transition Period Rules

It is proposed that to offset, in part, retroactive taxation of existing reserves at date of implementation, a similar rule to that in the White Paper be used but adapted to conform to the new formula as follows:

(a) that depletion allowances on the proposed basis (20% of gross depletable income) will apply for five years after implementation day without having to be "earned";

and in addition

(b) that during the period after November 7, 1969 (date of issue of the White Paper) to the end of five years after implementation day, a "bank" of "earned" allowances will be accumulated of 50% of eligible expenditures made during that period. Such "bank" would be available for use after the transitional period to supplement, until exhausted, any short fall of 50% of eligible expenditures in each year below 20% of gross depletable income.

Summary

Gulf Canada has endeavored to not only put forth its views on the White Paper proposals in this important area, but has also tried to be constructive and propose reasonable alternatives to meet its criticisms.

If the Gulf Canada recommendations are adopted, they would provide a basis which would maintain and encourage adequate and proper development in this natural resource area and contribute to the future growth and prosperity of Canada.

PROPOSALS FOR DEPLETION ALLOWANCES — OIL AND GAS

DEPLETION ALLOWANCES TO NON-OPERATORS

Present income tax regulations in respect of non-operators' depletion allowance provide that where a person has an interest in a resource and in the proceeds of sale of products therefrom, or receives a rental or royalty computed by reference to the amount or value of production from a resource, the deduction allowed is 25% of the amount included in computing his income for the year in respect of the interest in the proceeds or in respect of the rental or royalty, as the case may be.

The income from gross royalties is the most common form of interest in the oil and gas industry, which is subject to the non-operators' allowance.

The White Paper states that this allowance sought to recognize that royalties might well in part be a return of capital and now that the cost of acquiring mineral rights will be deductible under present proposals, it is proposed that this allowance be repealed.

The repeal of these depletion allowances represents retroactive taxation on royalties in existence prior to implementation day. It is therefore recommended that pre-existing royalty income should continue to be depletable under present rules until exhausted. If this is not possible, the minimum action should be to allow a transitional period of not less than five years during which the present allowances continue.

DIVIDENDS TO SHAREHOLDERS OF PUBLIC COMPANIES

Present Basis

Dividends received by Canadian shareholders from taxable Canadian corporations are presently taxed as follows:

(a) Individual shareholders are required to compute tax (at their applicable rates) on the gross dividend received and then are permitted to deduct 20% of the dividend from their tax. If the dividend is received from certain petroleum or mining corporations, the dividend is reduced by 10%, 15% or 20% (depending on the proportion of income derived from production by the paying corporation) and the net dividend only is taken into income and the tax (at the individual's rate) then reduced by the 20% tax credit calculated on the **net** dividend after depletion allowance.

(b) Corporations receive such dividends tax-free and do not include them in their taxable income.

(c) There is no requirement that tax paid by the issuing corporation be sufficient to cover the tax credits provided.

(d) There is no refund to individual shareholders who are in low or nil tax brackets, if the tax credit is greater than the tax otherwise payable.

(e) There is no 20% tax credit available to foreign shareholders, pension funds or other non-tax entities.

The purpose of the 20% tax credit is to provide some relief from the double taxation arising from the corporation paying tax on behalf of its owner shareholders who are then again required to pay tax on distribution. To avoid compounding this effect, intercorporate dividends are exempted from tax.

The depletion allowance is to recognize the wasting nature of natural resources and to provide for the "capital" returned in the dividend payment.

White Paper Proposals

With the contemplated broadening of the tax base to include capital gains on shares, the government proposes to integrate much closer the taxation of shareholders and the corporations they own.

To accomplish this, the White Paper proposes that for dividends paid after implementation day, the Canadian shareholder will be given credit for part of the tax paid by the corporation by letting shareholders gross-up dividends received by a maximum of 50% and, after applying their individual tax rates to the grossed-up amount, be allowed to deduct the amount of the gross-up from the tax. Refunds will be made if the net effect is to more than offset any tax otherwise payable.

The maximum gross-up of 50% of dividends is only available to shareholders provided there is sufficient "creditable" tax available from the tax paid by the corporation. Creditable tax is 25% of the corporation's taxable income and is only available after payment of tax on such taxable income. This means that tax must be paid and "creditable" tax equivalent to shareholder gross-up obtained **prior** to any dividends on which it is applied.

The proposal also envisages that the creditable tax will be accumulated, if not fully used, but that after 2½ years from the end of the fiscal year to which it applies, it will no longer be creditable.

The gross-up and credit routine will apply to Canadian shareholders only (individuals and closely-held corporations) and will not extend to Canadian pension funds, non-tax entities or to foreign individual or foreign corporate shareholders.

Intercorporate dividends between Canadian public companies will be grossed-up on the 50% maximum basis (if creditable tax is available from the issuing corporation) but, in order to avoid intermediate tax, will be subject to a special tax rate of 33⅓% instead of the regular corporation rate which will then be reduced by a tax credit equal to

the gross-up used. If the maximum gross-up of 50% is available, no tax should apply and tax computed on the dividend will be creditable on ultimate distributions to shareholders of the receiving company.

Shareholders' depletion allowances (as applicable to dividends from some petroleum and mining companies) are proposed to be cancelled. The argument advanced is that if half the losses realized on shares of such companies (capital losses) are allowed, then it is not necessary to recognize the return of capital inherent in the shareholders' depletion allowance.

Comments on White Paper Proposals

The integration proposals put forth are very complex and give rise to varying treatment of "creditable" tax availability. While the objective of integration is to avoid, at least in part, double taxation of corporate profits, it should be recognized that the result of the White Paper proposals is to tax in the hands of shareholders a portion of the earnings arising from incentive allowances and grants which are made tax exempt to the corporation to encourage activities beneficial to the economy. To tax the shareholders on such earnings negates the whole concept of integration.

Taxable income can fluctuate from or stabilize at a level below reported financial position of profits before income tax. Such a situation creates different creditable tax problems caused chiefly by the following factors:

(a) Capital cost allowances in excess of financial depreciation written

(b) Immediate deductibility of certain costs (which are capitalized or deferred on the corporation's financial records) in excess of amounts amortized

(c) Tax-free incentive allowances or grants

(d) Dividends received from controlled foreign subsidiaries

(e) Foreign source income from other than controlled foreign subsidiaries

(f) Exclusion of disallowed costs under the White Paper proposals and subsequent higher tax paid which does not provide any "creditable" tax.

(a) **Capital cost allowances in excess of financial depreciation written** arise normally when plant expansion occurs during growth situations and is one of the benefits of the present depreciation tax system by providing a source of funds for expansion. Similarly, the government offers accelerated write-offs for desirable investments in pollution equipment, etc. and for plant investment in depressed or remote areas under such legislation as the Area Development Incentives Act.

(b) **Immediate deductibility of certain costs (which are capitalized or deferred on the corporation's financial records) in excess of amounts amortized** such as acquisition of mineral rights, well drilling etc. These are allowed usually to provide recovery of initial investment by companies exploiting natural resources.

(c) **Tax-free incentive allowances or grants.** It is this factor which generally results in petroleum or mining companies maintaining a level of taxable income below financial profits before tax. Depletion allowances and research grants are the main tax-free items in this category. These tax-free amounts are extended and encouraged by the government for activities beneficial to the economy of Canada which might otherwise not be as economically feasible and hence might not, to the same degree, be undertaken by corporations. It would appear indefensible to tax the Canadian shareholders on the distribution of earnings arising from this cause and, in effect, the government would be, at least in part, recapturing such incentive allowances or grants from the shareholders.

(d) **Dividends received from controlled foreign subsidiaries,** would (subject to certain rules and in treaty countries) not be taxable and any income from this source would not produce "creditable" tax.

(e) **Foreign source income (other than "passive" income) from other than controlled foreign subsidiaries** would be taxable in Canada and subject to 15% minimum withholding tax which would be "creditable".

(f) **Exclusion of disallowed costs under White Paper proposals, and subsequent higher tax paid, which does not provide any "creditable" tax** could affect the ability of a corporation to a limited degree to provide "creditable" tax on dividends.

These very complicated regulations will cause substantial fluctuation from time to time in availability of creditable tax and its resultant effect on the taxes payable by its shareholders on dividends. However, it should be stressed that all companies will pay tax at full rates on all taxable income. While this may fluctuate from reported financial earnings before tax due to timing differences, tax is ultimately fully paid on all corporate pre-tax earnings except where tax-free allowances or grants are given to encourage desirable economic objectives related to the future growth and development of Canadian industry and resources.

With such a situation, we believe consideration should be given to alternative proposals which are simpler and more equitable as between corporations and which avoid varying impacts on shareholders.

Recommended Alternatives to White Paper Proposals

Gulf Canada believes that the complexity and variations arising from the White Paper proposals, could be simplified and the objective of partial elimination of double taxation accomplished by one of the following simple methods:

(1) Grossing-up the dividend received by the 50% maximum regardless of the extent to which it is supported by creditable tax in any year and allowing a tax credit equal to the gross-up;

or

(2) Retaining the present tax credit system but increasing the rate to 25%.

Either of these two suggestions (and Gulf Canada prefers the simplicity of the second alternative of the 25% tax credit) will provide a reasonable and uncomplicated method of partially eliminating double taxation without the administrative burden and inequity which arises from the more technical proposals of the White Paper.

The government states (paragraph 4.14) that there are two problems with tax credits:

(1) non deductibility if there is insufficient tax on other income to fully absorb the tax credit;

and

(2) its greater worth to higher income shareholders.

To overcome these objections, which are not in our opinion very serious problems, consideration might be given to a modest adjustment in tax credit rates to compensate and make any resultant net tax credits (after absorbing tax otherwise payable) refundable.

Such an adjustment in tax credit rates could be:

Taxpayer's Marginal Rate	Tax Credit Rate
30% or less (under $4,000 taxable income)	35%
Over 30% to 40% (under $13,000 taxable income)	30%
Above 40% (over $13,000 taxable income)	25%

To put these recommendations in perspective, the following comparisons can be made (since the new progressive rate schedules start at 21.76% of taxable income and (after five years) reach a maximum of 51.20%, the only rate areas to really consider are those used below).

Tax Payable per $100 Dividend	Individual's Tax Rate 30%	40%	50%
1. Present Basis			
(a) With 20% tax credit	$10	$20	$30
(b) With 20% depletion allowance and 20% tax credit	8	16	24
2. White Paper Proposals			
50% Gross-up and credit	(5)	10	25
3. Alternatives Proposed			
(a) 50% Gross-up and credit	(5)	10	25
(b) 25% Tax credit	5	15	25
(c) Variable Tax credit	(5)	10	25

It will be noted that alternatives 3(a) and 3(c) equate with the White Paper proposals and 3(b) meets the White Paper level at the 50% tax rate (over $24,000 taxable income).

Since one-half of capital gains on public company shares will be taken into income the 3(b) rate on dividends will correspond to the tax levied on capital gains at the 50% marginal rate but exceed the tax on dividends at lower tax rate levels. This should avoid any possible benefit obtainable by converting dividend income into capital gains particularly for those having taxable incomes over $24,000 where most of the opportunities would lie.

If the alternative recommendations are not accepted and the complex integration proposals of the White Paper proceeded with, there are areas which should be

adjusted to ensure minimum difficulty to shareholders. These are:

(a) creditable tax should be computed on an annual basis

(b) a reasonable transition period should be provided

(c) creditable tax should be allowed, as an addition to the "creditable tax bank", on tax-free incentive allowances and grants.

(a) **Creditable tax should be computed on an annual basis** rather than on tax instalments (based on previous year or current estimates) which are paid prior to dividend payments. Gulf Canada currently pays dividends January 2, April 1, July 1 and October 1 of each year and it is manifestly impossible to have, at the start of the new system, adequate tax payments made prior to at least the first dividend. In any event, the suggested basis is the most involved one possible and could result in different levels of tax credits applying to each quarterly dividend which would cause administrative burdens of reporting on T5's as well as untold confusion to shareholders. We see no reason why an annual basis cannot be considered (just as Gulf Canada now employs to determine shareholders' depletion rates) even if this means filing a preliminary estimate of taxes payable for the previous year in the following January, with any difference between estimated and actual adjusted in the following estimate. Such a basis avoids having varying rates during the year with the necessity of advising shareholders of their gross-up and credit on each dividend payment. Gulf Canada provides, on February 28th of each year, a T5 summary which gives the information as to gross dividend, tax credits etc. on an annual basis to its shareholders. As corporation taxes are fully paid by March 31st of the following year, the government will not be placed in the position of allowing shareholder credit for tax paid prior to the receipt of the corporate tax.

(b) **A reasonable transition period should be provided.** Because corporations will be placed in differing positions as to creditable tax by the government's proposals, it is only fair that a reasonable transitional period be permitted, during which shareholders can gross-up to maximum. Gulf Canada finds itself in the position of minimum creditable tax for the next year or so, due to accelerated depreciation allowed on major construction in a depressed area (under Area Development Incentives Act). Such action, encouraged by government, surely should not result in adverse consequences to shareholders particularly since it is a timing adjustment only and will ultimately result in higher taxes in subsequent years.

We would, therefore, propose that during the first five years of the new system that a maximum 50% gross-up and credit be permitted, even if, in the earlier years this puts the "creditable tax bank" in a negative position, with the obligation that if a net deficit results at the end of the five year period, this deficit would be paid to the government as prepaid taxes at that time.

(c) **Creditable tax should be allowed, as an addition to the "creditable tax bank", on tax-free incentive allowances and grants.** Gulf Canada has already outlined (on page 22) its thinking on tax-free incentive allowances and grants. It is difficult to conclude that, when activities are advantageous to Canada's economy and growth, the government intends to penalize and, in fact, recapture from shareholders, incentive allowances and grants given to promote such desirable endeavours. Therefore, we propose that the government allow creditable tax (25% of allowances and grants) to be added to the "creditable tax bank" each year and to be passed through to shareholders as gross-up and credit. This will also ensure a partial offset to the proposed elimination of shareholders' depletion allowances.

Intercorporate Dividends

Under the alternatives proposed by Gulf Canada (50% gross-up and credit with no requirement to conform to prior taxes paid or preferably either the 25% or variable tax credit basis) all dividends between public companies should be tax-free to the receiving company. This will continue the present simple and effective system and avoid the special rate problems required under the White Paper proposals.

Staledating of Creditable Tax

If the integration proposals embodied in the White Paper are enacted as written rather than the simpler alternatives proposed by Gulf Canada, a problem can arise due to the proposed rule that creditable tax must be used within 2½ years after the end of the fiscal year to which the tax applied. Many additional regulations will be required to determine application of taxes paid on reassessments made after the creditable period has expired and similar problems.

This provision also puts pressure on the use of stock dividends to prevent tax from staledating and while this may be advantageous to lower tax bracket shareholders it is not desirable for those with 50% marginal rates. Federally incorporated companies will, due to restrictions, have difficulty in issuing stock dividends since, from a practical viewpoint, fractional shares cannot be issued. Gulf Canada has 28,000 Canadian shareholders and our study indicates fractional shares could be involved for most of the shareholders. We point out again that these complications arise from the involved integration proposals in the White Paper which can be completely eliminated if one of the simpler alternatives proposed is adopted.

However, if the government's integration proposals as outlined in the White Paper remain, Gulf Canada proposes that the period during which creditable tax can be applied to dividends paid be extended to at least five years after the year in which it is earned.

DIVIDENDS TO SHAREHOLDERS OF PRIVATE COMPANIES

At present dividends received from Canadian companies are treated alike in the hands of Canadian taxpayers with allowances, where applicable, for depletion and 20% tax credits.

The White Paper proposes that Canadian corporations be divided into two categories—closely-held (private) and widely-held (public). Generally the widely-held companies would be those whose shares are listed on a stock exchange or traded over the counter. All others are closely-held corporations. Once a company is treated as widely-held, it cannot (in the event of one person or corporation acquiring all the shares) change its status to closely-held, but the latter can change to widely-held by issuance of stock to the public.

Different rules would apply to dividends paid by the closely-held corporation (providing taxes of 50% have been paid on pre-tax earnings) with the recipient grossing up the dividend by 100% and deducting the gross-up from the tax calculated at the receiving individual's or corporation's rate. Provided full creditable tax is available, no tax will be collected from the shareholder if his rate is 50% and there will be a refund to those whose tax rates are less than 50%.

As against this treatment dividends received from Canadian widely-held companies (as previously outlined) will be subject to a maximum gross-up and credit of 50% of the dividend.

The rationale for the distinction between corporations is stated as closer identification of shareholders as owners for the private companies and that generally private companies compete with unincorporated partnerships, proprietorships and other closely-held corporations. Gulf Canada is not persuaded that this is a valid distinction and believes that all corporations compete against each other and all business in their field regardless of their size or type of organization. When it is con-

sidered that General Motors, Union Carbide and Eatons are examples of closely-held companies, we do not believe this neat division has any real meaning.

Gulf Canada has previously emphasized the need for simplicity in tax laws and believes that the distinctions being made as between different Canadian companies are very complex, not realistic, are discriminatory and should be abandoned.

Gulf Canada, therefore, recommends that all Canadian corporations be treated alike as previously proposed for public corporations—namely, for dividends received a 50% gross-up and credit (without requiring creditable tax rules) or preferably a 25% or variable tax credit. Similarly intercorporate dividends between all Canadian companies should be tax exempt.

Partnership Option and Consolidated Returns

The White Paper proposes that shareholders of closely-held Canadian corporations can, subject to certain restrictions, elect to be taxed as if the corporation were a partnership.

Gulf Canada believes this is a progressive step and should be made available to all corporations with a limited number of shareholders (possibly not more than 15) who are all Canadian and who sign any necessary election to be so taxed together with any necessary restriction on fiscal year-ends and variable sharing of profits.

Such an arrangement will permit a long overdue reform, to at least a limited degree, by permitting a partial consolidation of qualifying Canadian subsidiaries with their Canadian parent company.

CAPITAL GAINS AND LOSSES

Gulf Canada appreciates the need to broaden the tax base and agrees with the selective inclusion in income of a portion of **realized** capital gains and losses provided that this is part of a system which includes liberal averaging provisions, top personal and corporate rates of around 50% and unlimited carry forward of losses. Gulf Canada does not agree with any inclusion of deemed gains or losses arising from unrealized increases or decreases in value.

Gulf Canada believes that any incidence of tax arising from realized capital gains should not exceed that levied by the United States, our chief source of investment capital. It would be wiser to approach capital gains taxation cautiously and levy lower rates of tax until the impacts are known. Certainly to levy a higher tax than that of our trading partners in the free world would be dangerous and place in jeopardy the investment flow urgently needed for the development and economic growth of Canada.

Gulf Canada therefore proposes that realized capital gains or losses be taken into income to the extent of not more than one-half the gain or loss and tax applied at regular corporate or personal rates subject to a maximum rate on such capital gains or losses of not more than 50% during the first five years when the top personal rates are still relatively high. In fact, it would be Canada's advantage to maintain its rates below those of our more mature competitors, United States and United Kingdom, neither of which introduced taxation of capital gains until maturity of capital investment was reached. This could be done by taking 25% of the capital gain or loss into income. Such a step would continue to encourage inflow of foreign investment capital which Canada requires if growth, at an acceptable rate, is to be accomplished.

Capital Gains (Losses) on Sale of Shares of Incorporated Companies

Gulf Canada has already outlined its recommendations that there be no distinction as to tax treatment of dividends received as between public or private corporations

and similarly recommends uniform tax treatment of capital gains or losses from realization of shares of all incorporated companies.

Gulf Canada concurs with the inclusion in income of not more than one-half of capital gains (losses) on **realization** of company shares provided that, during the first five years of the new system when the individual rates are being reduced (from about 82% to 51%), such capital gains (losses) should be taxed at no higher than a 50% maximum rate.

However, Gulf Canada cannot agree with the White Paper proposal that shareholders of public companies revalue their shares every five years and include in income one-half of the **unrealized** gain or loss over the market value on "valuation day" or a subsequent five year anniversary date.

Not only could such a rule cause a forced sale of stock, if the **deemed** gain were substantial, but the shareholder could find himself in the position of reducing his equity to pay for the tax, and shortly thereafter finding that the "paper" gain is, in fact, lost by a decline in market price. There is a wide fluctuation in most of the market prices of public shares as can be illustrated by Gulf Canada shares which have in the last two years traded as follows:

	Low	High	% Variation
1969	$16.00	$25.50	60%
1968	$17.12	$24.62	44%

Gulf Canada contends that the use of market prices and any consequent partial inclusion in income of deemed gains based on such market prices is inequitable and becomes taxation by fortuitous circumstances.

Market trading is usually based on only a limited number of shares and resultant market prices are fairly volatile. "Tax-loss" selling (such as occurs towards year-end in the U.S.A.) can have a major effect on market price. Factors such as these coupled

with the unfairness of taxing a fluctuating basis make the the fair taxation of unrealized gains based on market price of shares futile.

The most serious problem will arise from quinquennial revaluation of the shares of holders of blocks of 25% or more of the outstanding stock. The arguments in the White Paper (para. 3.36) that shares of public companies are readily marketable and taxpayers can realize gains or losses fairly easily is not true when it is applied to major shareholders who may hold millions of shares for which no ready market is available. Gulf Oil Corporation, a U.S. Corporation, holds nearly 70% of the stock of Gulf Oil Canada Limited. A calculation has been made of the effect of such a revaluation and tax on half the unrealized gain for the next five years (using earning projections, normal price-earning ratios and assuming dividend payout of one-half of earnings after tax). The result was a tax on the deemed capital gain in excess of the sum of the five years' dividend and no return was earned by Gulf Oil Corporation for the five year period on its major investment in Gulf Canada stock. This is not taxation but confiscation.

For all of these reasons Gulf Canada strongly recommends that the quinquennial revaluation of shares and consequent taxation of unrealized gains be abandoned in its entirety.

Other Capital Gains Considerations

(a) It is recommended that there should be no capital gains tax on principal residences or depreciable personal property. Many of these gains are inflationary gains and the White Paper proposals would require every Canadian to keep detailed records and are administratively onerous. If this is not possible at least unlimited roll-overs should be allowed without restriction and a life-time exemption of gains of $25,000 (or possibly $50,000) allowed on final realization. Similar rules should apply to owner-occupied farms.

(b) That gifts or bequests to charitable or educational recipients should not be subject to capital gains or gift tax.

(c) That valuation options should be permitted of the greater of cost or value on "valuation day". This will avoid, to some degree, retroactive taxation of assets or shares which are depressed as to value on valuation day, below original cost to the taxpayer, but which subsequently recover and are realized at a price equal to or higher than cost. Where independent appraisals are obtained as to value on "valuation day", the appraised values should be binding on both the taxpayer and the government to avoid untold litigation. Any appraisal costs should be deductible from income and not merely added to asset value.

(d) Capital gains proposed on non-residents (presently not taxable by treaty) should be reviewed. Normally such gains are taxable by the non-resident's country and in effect the Canadian proposal is to divert the tax to Canada from the treasury of the non-resident's country. It could only be expected that reciprocal arrangements would apply even if the treaties can be renegotiated.

(e) That a more liberal system of income averaging be allowed, possibly on lines recommended by the Royal Commission on Taxation. The White Paper proposals are minimal and should be expanded to be of any real value.

(f) With the introduction of capital gains taxation, estate taxes (and provincial succession duties) should be reviewed and modified perhaps by reducing such taxes on capital over a transitional period.

CERTAIN AREAS OF BUSINESS INCOME

Gulf Canada welcomes the government's conclusions not to propose major changes to the well-tested definitions of business and property income as determined under present tax law. Certain changes are proposed, some good and others with adverse and possible unforeseen impacts if they are applied generally rather than to the specific situations they are intended to affect.

1. Nothings

Under present tax rules there is a class of expenditure which is presently known as "nothings" consisting of those expenditures that are not deductible in calculating income subject to tax either by being allowed in full at the time the expenditure is incurred or by way of periodic charges against income over an extended period.

Gulf Canada is pleased to see that the proposed legislation would create a new depreciation class which would include all these types of expenditures and permit the taxpayer to deduct 10% of the book value of the class each year for all "nothings" acquired after implementation day.

Gulf Canada submits that the enabling legislation defining the items to be included in the class should be specific rather than general so that uncertainty and consequent controversy with the tax authorities be kept at a minimum. In addition, as the proposed arbitrary ten-year limitation for the write-off of these items may not always be logical, Gulf Canada proposes that the allowance be limited to the lesser of the ten-year write-off or the life expectancy or usefulness of the item provided this can be demonstrated.

Gulf Canada does not agree with the proposed treatment of purchased goodwill or that it should be included in a class of "nothings" and written off as proposed above. Goodwill, while intangible, is an asset, like land, which does not depreciate through use. Any capital gain (or loss) on disposition should be treated in the same manner as

for any other capital asset. The White Paper proposes partial retroactive taxation of pre-existing goodwill and this feature together with the allocation problem arising from purchase of assets and varying treatment proposed as to treatment of goodwill as between different types of companies can be avoided, if the real nature of goodwill is recognized.

Gulf Canada, therefore, proposes that purchased goodwill should not be put in the "nothings" class and depreciated but that when the underlying assets are sold, any loss or gain be treated the same as any other capital gain.

2. **Treatment Proposed For Rental Buildings Costing in Excess of $50,000 and the Holding of Property**

The White Paper proposes the closing of what it calls a "loophole" whereby it is stated that landlords through the process of buying and selling buildings, can postpone tax to the point that it becomes "tax saved forever". One of the ways the White Paper proposes to accomplish this is to put each rental building costing $50,000 or more in a separate depreciation class and when sold any excess or deficiency over capital cost allowance claimed will be added or deducted from income.

In addition, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance, interest, or property taxes. This means that a loss from holding property will be deductible only if it represents the excess of other allowable expenditures over revenues. Although the White Paper does not deal with the point, the excess interest and property taxes will presumably be added to the cost of the property for the purpose of future capital cost allowances and also for the purpose of determining any ultimate capital gain. Otherwise they would become nothings, which the White Paper proposes to eliminate.

Gulf Canada points out that these provisions (while probably not intended to apply) do not exclude from their application, industrial and commercial operations of

business where rental buildings and property holdings are basic bona fide working assets of the business and any net rental income or loss is entirely incidental to providing marketing outlets for its products. Gulf Canada anticipates the need to build several hundred retail outlets (with buildings costing more than $50,000) during the next decade. Some of these will be leased, from time to time, to dealers and agents under lease and franchise agreements, while some will be company operated, and there will undoubtedly be periodic transfers between these two basic types of retail operation. Gulf Canada does not believe that it was the government's intention to impede proper industrial and commercial arrangements necessary to conduct proper retail operations where net rental costs are no more than a legitimate cost of retail distribution.

The "holding property" proposals are of even greater concern to Gulf Canada. First, no definition is given of "property" and it is not clear what is included beyond real property. Second, the denial of losses to any national industrial company (which explores, produces, refines and retails) from holding property is inconceivable when consideration is given to the thousands of properties required as working assets in the form of oil and gas properties, retail, bulk plant and refinery sites. The administrative task alone of determining the taxable status would be almost prohibitive as to cost and complexity if each property had to be dealt with separately.

Gulf Canada, therefore, proposes that the application of the provisions outlined for tax treatment of rental buildings costing $50,000 or more and the holding of property be clarified to ensure they do not apply to bona fide operation of industrial and commercial corporations.

ENTERTAINMENT AND RELATED EXPENSES

The government proposes to set more rigorous limits to check "expense account living". The costs of attending conventions and belonging to social and recreational clubs would no longer be permitted as a charge in determining business income. The

costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded.

Gulf Canada believes the government is taking a most extreme position in denying all deductions because they have found some abuse. The legitimate expenses (conventions, certain entertainment, etc.) are a proper cost of carrying on business and should be allowed. Certainly, industry generally through their own internal check procedures, control such expenditures usually to a more stringent level than the tax assessor might deem necessary. Gulf Canada believes that the present Income Tax Act contains provisions which are adequate to control any abuse and is of the opinion that, rather than the government adopting such sweeping and harsh measures as those proposed to assure that no abuse exists, departmental practice should be tightened under existing legislation.

If the government does not accept that "tightening up" will be sufficient, Gulf Canada proposes that guidelines be established and made part of the regulations. Such guidelines could be based on the United States Internal Revenue Code, Section 274 but it is hoped that any guidelines that are developed will require only minimum record keeping to ensure administrative compliance.

GENERAL COMMENTS

1. Mining

Gulf Canada is involved in mining operations in Canada through its participation in activities of Syncrude and Gulf Minerals Company. Since these companies are presenting briefs directly to the government committees, Gulf Canada will only comment on this important resource area.

It is regrettable that mining and petroleum are, throughout the White Paper, dealt with as one subject. Actually the factors affecting the development and economics of these two industries are quite different and should be considered separately. Petroleum companies deal with many properties across vast areas and exploration and development costs are major components of their continuing operation. This is substantially different in degree from normal mining operations. Both industries are risky and both require adequate incentives if they are to attract sufficient investment to ensure maximum development of Canada's vast natural resources. For these reasons, properly developed incentives for petroleum companies are not necessarily adequate or proper for mining activities.

2. Single Tax Rate for Corporations

Gulf Canada concurs with the proposal that only one rate of corporation tax apply for all companies but that if this is done there should be relieving provisions to allow retention of funds to promote growth since small companies normally have only limited access to outside financing. This can be in the form of accelerated capital cost allowances (if the business is capital intensive) or perhaps by deferring taxes due for a period of years. Any such relief should, under controlled conditions, be available to all small business, whether or not incorporated. The use of the partnership option should also be available to corporations under reasonable conditions.

3. Mobility of Individuals

Gulf Canada, being a member of a world-wide group of related corporations, is able to offer to its employees the benefits of world-wide experience. In a highly technical industry such as the petroleum industry, it is often advantageous to move skilled personnel across international boundaries. This exchange of specialized talents is, in our opinion, very beneficial to the company, the employee and to the country as a whole. However, the deemed realization of gains upon a taxpayer's departure from Canada would discourage a person from leaving the country for a short period of time and others from entering on a similar basis.

It is, therefore, Gulf Canada's opinion that this proposal is not in the best interest of Canada and should not be adopted.

4. Corporate Reorganization

The White Paper proposals regarding corporate reorganizations are not very definitive and, it is difficult to appreciate the full significance of what rules will apply. It is Gulf Canada's recommendation that the enabling legislation should not place tax barriers in the way of normal commercial development, which may include the necessity (on grounds of efficiency) to amalgamate acquired companies into the parent company.

5. Simplicity, Certainty and Administration

Gulf Canada would like to finish its recommendations, which are intended to be constructive alternatives to proposals set forth in the White Paper, by stating its plea for one of the most important attributes of any fair tax system, namely, that it be simple, certain and administratively sound.

Many of the government's proposals are extremely complex and there seems to be an intense preoccupation with every last possible "leak" regardless of the paucity of revenue involved. While a theoretically perfect system may be technically desirable it is doubtful from a practical viewpoint that such a system fits a free-enterprise system composed of human beings. There is an unfortunate attitude throughout the

White Paper that any one who legitimately minimizes his taxes should be stopped even if this means arbitrarily blocking perfectly valid actions. Incentives are considered at a lower level of desirability than equity and begrudgingly granted at reduced levels or eliminated with little shrift and explanation.

Gulf Canada believes as strongly as the government in the need for tax reform. Relief to low income taxpayers, child care cost deductions, allowances for employment expenses (although minimal) are all welcome additions to the tax system and are long overdue. Gulf Canada does not agree with scrapping many well-tested areas of tax law to try experimental approaches that have untested and unknown effects on the future economic development of the country.

Simplicity is imperative if self assessment is to work and Gulf Canada has tried throughout to propose simple, straight-forward alternatives with this in mind.

Certainty is an area which should be carefully considered in drafting legislation. It is difficult to determine from some of the White Paper statements what is specifically intended, since many are vague and it should be a matter of principle to ensure that these are clarified so as to avoid all areas which may give rise to misunderstandings and possible litigation.

Administration is one aspect, perhaps understandably, that is not covered by the White Paper but which should be given prime consideration. Gulf Canada considers that present rules which do not provide for binding advance rulings and which require payment of assessment before a taxpayer can argue his case in court are not fair and should be amended. Similarily the inequity in the present law whereby a taxpayer is required to pay on underpayments of tax, interest at 6% which is not tax deductible makes the rate 12% in most cases while refunds of overpayment attract only 3% interest from the government, which is taxable, so that the taxpayer ends up with 1½%. This is unfair treatment and should be corrected. There are other administrative areas that should be examined and Gulf Canada strongly recommends a complete review to ensure that fairness is the keynote of any new legislation.

APPENDIX "H"

NAME: GULF OIL CANADA LIMITED

SUBJECT: Certain Aspects of the White Paper Proposals

Analysis of Appendix "G" by Senior Advisor

This brief has been filed by Gulf Oil Canada Limited.

The brief itself comprises:

1. An introductory statement that any tax revisions should accomplish

   (i) Fairer taxation

   (ii) Maintenance of incentives

   (iii) Simplicity

   (Page 4 of brief)

2. Specific comments on the following aspects of the White Paper

   (i) Depletion (Page 7 of brief)

   (ii) Integration or Grossing-up of Canadian dividends (Page 19 of the brief)

   (iii) Consolidated tax returns (Page 30 of the brief)

   (iv) The Capital Gains Tax (Page 31 of the brief)

   (v) Goodwill (Page 35 of the brief)

   (vi) Capital Cost Allowances on Rented Buildings (Page 36 of the brief)

   (vii) Entertainment Expenses (Page 37 of the brief)

   (viii) General Comments (Page 39 of the brief)

Members of the Committee will be interested in the following summary of the views presented in the brief:

Gulf Oil Canada Limited summarizes below the main points included in the attached brief to the government in response to the request for comments and suggestions on the White Paper on Tax Reform.

1. Welcomes the chance to make its suggestions and believes any redistribution of tax burden should be based on fairness, maintenance of adequate incentives and simplicity.

2. Considers proposals for depletion allowances to be insufficient to attract proper level of exploration and development and proposes a more satisfactory basis by broadening the "eligible" base and changing the formula to 20% of gross income limited to 50% of eligible expenditures. Proposes a transitional period for non-operators' depletion allowance.

3. Proposes simpler and more equitable basis for integrating dividend and personal income by either gross-up and credit of 50% regardless of creditable tax or preferably continuing tax credits at 25% or on a variable tax credit basis. Intercorporate dividends would be exempt from tax.

If this is not acceptable, suggests changes to White Paper to put creditable tax on an annual basis, provide a reasonable transitional period and permit creditable tax to be allowed on tax-free incentive allowances and grants together with extension of the period during which creditable tax can be used from two and a half to five years.

4. Proposes that no distrinction should be made between closely-held and widely-held companies. Both should be handled for dividends as outlined in 3 above.

5. Recommends that the partnership option should be available to companies that qualify, whether closely-held or widely-held.

6. Proposes that for capital gains taxation, a maximum of half of realized gains or losses be taken into income (with suggestion for lower rates as being more appropriate) on all applicable assets including shares of all companies. No deemed gains should be recognized. Principal residences, owner occupied farms and depreciable personal property should not be subject to

capital gains treatment, or if this is not accepted, be subject to unlimited roll-over with a lifetime exemption of gains of $25,000 or $50,000. Gifts and bequests to charitable or educational recipients should be exempted. Valuation options should be permitted of the greater cost or value on "valuation day". Independent appraisals should be binding and appraisal costs deductible. Non-resident capital gains proposals should be reviewed since reciprocal action will likely result. Liberal income averaging, greater than proposed, should be allowed. Estate taxes (and provincial succession duties) should be reviewed and modified with introduction of capital gains.

7. Welcomes write-off of "nothings" and suggests minor improvements together with recommendation that goodwill not be included.

8. Requests clarification to ensure that tax treatment of rental buildings and holding of property does not apply to industrial operations.

9. Suggests that abuse of entertainment and similar costs can be adequately controlled through present regulations. If this is not acceptable, suggests guidelines similar to U.S. Internal Revenue Code Section 274.

10. Points out that mining and petroleum are quite different and should be considered separately for type and adequacy of incentives.

11. Concurs with a single corporate tax rate but proposes that relieving provisions should be made for small businesses whether or not incorporated. Partnership option should be available under reasonable conditions.

12. Believes that desirable mobility of employees to leave Canada for training and experience be encouraged and the deemed realization at time of departure eliminated.

13. Recommends that tax barriers should not be placed in way of normal commercial consolidations and amalgamations.

14. Strongly urges that simplicity, certainty and administrative fairness be the keynotes and points out areas which should be improved.

There is attached the usual summary of existing income tax legislation, White Paper proposals and the principal points of the brief.

GULF OIL CANADA LIMITED

Principal Subject: Depletion

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act and Regulations allow percentage depletion of 33 1.3% of the balance of oil production revenues remaining after deducting the capital cost allowances and 83A credits claimed as a deduction in the year.	1.52 The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Every $3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to $1 of depletion allowances if and when his production profits permit. Depletion allowances on new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system. *Percentage Depletion* 5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is 33⅓ per cent. Special rates of depletion are provided for gold and for coal.	Pages 7 to 18 of brief This portion of the brief states: There are two areas which, in our opinion, require revision: (1) broadening the base of the "eligible" expenditures on which the allowance is to be calculated (2) changing the method of application to provide a more efficient basis of annual allowances. The present 83A costs include acquisition of mineral rights and the White Paper proposes that they continue to be fully deductible for tax purposes in the year incurred. However, it also proposes that they will not be included as "eligible" expenditures and no allowance will be granted on their cost. The Finance Department stated that the inclusion of such acquisition costs could, in their opinion, result in manipulation between companies (selling and buying in alternate years) to increase their "earned" depletion. While this could be possible, it could not apply to acquisition costs of mineral rights directly from the Crown (provinces and federal government) and we see no reason why, at least to this extent, that the inclusion of this primary exploration cost should not be allowed as an "eligible" expenditure. Under present rules these tangible assests (well head equipment, flow lines, tank batteries etc.) are depreciable and are excluded from the 83A costs that are fully deductible in any one year. There is, however, no question but that these are necessary costs in developing oil and gas reserves. Hence we believe these should be allowed as "eligible" expenditures for the sole purpose of determining depletion allowances.

Name: GULF OIL CANADA LIMITED

Principal Subject: Depletion

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	Therefore, it is Gulf Canada's opinion that from the strictly risk point of view gas plants should be considered as eligible expenditures for the earning of depletion allowances. Gulf Canada therefore proposes that, in the light of the arguments put forth above, capital expenditures for gas plant construction should be included in the definition of "eligible" expenditures. Therefore, Gulf Canada believes that revisions are necessary to the formula proposed in the White Paper and that such revisions should accomplish the two objectives of: (a) Correcting the present inefficiency arising from continuing to use the "net" basis as a limit, which results, in any one year, in reducing allowances as eligible expenditures increase. This can be corrected by using gross depletable income (after royalties) as a base and applying a lower (but generally equivalent) percentage of 20% of "gross" depletable income instead of 33⅓% of "net" production profits; and (b) Adjusting the rate of "earning" depletion allowances to a more reasonable level than the White Paper proposal of one-third of eligible expenditures which results in the situation that (at the point at which the maximum allowance is reached in any one year) the eligible expenditures are 1½ times the net cash flow after taxes (net

Name: GULF OIL CANADA LIMITED

Principal Subject: Depletion.

Present Tax Law

White Paper Proposals

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

Principal Points of Brief

production profits less taxes payable). This can be shown by the table below where this maximum point occurs when eligible expenditures are 40% of gross depletable income as compared to the net cash flow after taxes of 26.7% of gross depletable income (net production profit of 40% less taxes of 13.3%). This result is unrealistic over a long period in terms of available funds which will be insufficient to accomplish the objective of maintaining a satisfactory level of exploration and development activity.

Gulf Canada believes that a more satisfactory basis would result from modestly changing the rate of allowance from one-third of eligible expenditures to one-half. At this proposed rate, the eligible expenditures would equal the net cash flow at the level of 32% of gross depletable income.

Gulf Canada therefore proposes that depletion allowances be computed on the basis of **20% of gross depletable income (after deducting royalties) limited to 50% of eligible expenditures.**

It is proposed that to offset, in part, retroactive taxation of existing reserves at date of implementation, a similar rule to that in the White Paper be used but adapted to conform to the new formula as follows:

(a) that depletion allowances on the proposed basis (20% of gross depletable income) will apply for five years after implementation day without having to be "earned";

and in addition

Name: GULF OIL CANADA LIMITED

Principal Subject: Depletion

Present Tax Law	White Paper Proposals	Principal Points of Brief	Comments
		(b) that during the period after November 7, 1969 (date of issue of the White Paper) to the end of five years after implementation day, a "bank" of "earned" allowances will be accumulated of 50% of eligible expenditures made during that period. Such "bank" would be available for use after the transitional period to supplement, until exhausted, any short fall of 50% of eligible expenditures in each year below 20% of gross depletable income. Gulf Canada has endeavored to not only put forth its views on the White Paper proposals in this important area, but has also tried to be constructive and propose reasonable alternatives to meet its criticisms. If the Gulf Canada recommendations are adopted, they would provide a basis which would maintain and encourage adequate and proper development in this natural resource area and contribute to the future growth and prosperity of Canada.	

Name: GULF OIL CANADA LIMITED

Principal Subject: Integration of taxes on companies and individuals.

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not contain any such proposal.	The White Paper proposals respecting grossing-up of Canadian dividends were reviewed in Special Study No. 4 of March 4th, 1970, entitled "Grossing-up of Canadian dividends."	Pages 19 to 30 of brief. This portion of the brief states that: Gulf Canada believes that the complexity and variations arising from the White Paper proposals, could be simplified and the objective of partial elimination of double taxation accomplished by one of the following simple methods: (1) Grossing-up the dividend received by the 50% maximum regardless of the extent to which it is supported by creditable tax in any year and allowing a tax credit equal to the gross-up; or (2) Retaining the present tax credit system but increasing the rate to 25%. Either of these two suggestions (and Gulf Canada prefers the simplicity of the second alternative of the 25% tax credit) will provide a reasonable and uncomplicated method of partially eliminating double taxation without the administrative burden and inequity which arises from the more technical proposals of the White Paper. Gulf Canada, therefore, recommends that all Canadian corporations be treated alike as previously proposed for public corporations—namely, for dividends received a 50% gross-up and credit (without requiring creditable tax rules) or preferably a 25% or variable tax credit. Similarly intercorporate dividends between all Canadian com-

Name: GULF OIL CANADA LIMITED

Principal Subject: Consolidated Tax Returns

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Law does not provide for consolidated tax returns.	5.22 The government considers that its proposal whereby a corporation can be treated as a partnership would permit groups of corporations to achieve the same result as they would under consolidated returns. Therefore, the government does not propose to provide for consolidated returns as such. 4.21 This objective will best be achieved in those instances in which the corporation can elect to be taxed as a partnership. Under this option, the corporation would not pay any corporation tax at all, but each shareholder would pay personal tax each year on his share of the corporation's profits. 4.22 If this rule were applied to all closely-held corporations, there would be instances in which shareholders who own a few shares in the corporation would be forced to pay tax when they do not receive any income from the corporation, and have no means at their disposal to force the corporation to declare dividends to provide cash with which to pay the tax. Consequently it is proposed that this "partnership option" be available only in those instances in which all shareholders sign an election that the corporation's profits be taxed in this manner. 4.23 For technical reasons, three restrictions must be imposed on corporations that can be treated as partnerships. First, it must be clear what portion of the profits each shareholder is going to receive. This would usually mean that the corporation can have only one class of shares, although there may be instances in which the respective	Page 30 of the brief This portion of the brief states: The White Paper proposes that shareholders of closely-held Canadian corporations can, subject to certain restrictions, elect to be taxed as if the corporation were a partnership. Gulf Canada believes this is a progressive step and should be made available to all corporations with a limited number of shareholders (possibly not more than 15) who are all Canadian and who sign any necessary election to be so taxed together with any necessary restriction on fiscal year-ends and variable sharing of profits. Such an arrangement will permit a long overdue reform, to at least a limited degree, by permitting a partial consolidation of qualifying Canadian subsidiaries with their Canadian parent company.

Name: GULF OIL CANADA LIMITED

Principal Subject: Consolidated Tax Returns

Present Tax Law	White Paper Proposals	Principal Points of Brief
	rights of different classes of shareholders would be unchanged by differing future circumstances, including winding up the corporation. Secondly, all shareholders must be individuals resident in Canada or corporations incorporated in Canada. If the profits are to be taxed according to the circumstances of the shareholder, the government must be able to determine what those circumstances are, and whether the person in whose name the shares are registered is in fact the owner of the shares and not a nominee. Finally, if some shares are held by Canadian corporations, those corporations must have the same fiscal year-end as the corporation itself. In the absence of this year-end rule, it would be possible to postpone tax for several years by using a chain of corporations with appropriate year-ends. 4.32 Taken together these proposals concerning closely-held corporations should provide a tax system with the same effect on business carried out through such a corporation as on business carried on through a proprietorship. It should also collect the same tax on the investment income of a Canadian individual whether he holds his investments directly, or whether he holds them through a personal holding corporation.	

Name: GULF OIL CANADA LIMITED

Principal Subject: The Capital Gains Tax

Present Tax Law	White Paper Proposals	Principal Points of Brief	Comments
The present Income Tax Act does not impose any income tax on capital gains.	The White Paper proposals respecting capital gains are contained in Chapter 3 and are not repeated here.	Pages 31 to 34 of the brief. This portion of the brief states: For all of these reasons Gulf Canada strongly recommends that the quinquennial revaluation of shares and consequent taxation of unrealized gains be abandoned in its entiretv. (a) It is recommended that there should be no capital gains tax on principal residences or depreciable personal property. Many of these gains are inflationary gains and the White Paper proposals would require every Canadian to keep detailed records and are administratively onerous. If this is not possible at least unlimited roll-overs should be allowed without restriction and a life-time exemption of gains of $25,000 (or possibly $50,000) allowed on final realization. Similar rules should apply to owner-occupied farms. (b) That gifts or bequests to charitable or educational recipients should not be subject to capital gains or gift tax. (c) That valuation options should be permitted of the greater of cost or value on "valuation day". This will avoid, to some degree, retroactive taxation of assets or shares which are depressed as to value on valuation day, below original cost to the taxpayer, but which subsequently recover and are realized at a price equal to or higher than cost. Where independent appraisals are obtained as to value on "valuation day" the appraised values should be binding on both the taxpayer and the government to	

Name: GULF OIL CANADA LIMITED

Principal Subject: Capital Gains Tax

Present Tax Law	White Paper Proposals	Principal Points of Brief
		avoid untold litigation. Any appraisal costs should be deductible from income and not merely added to asset value. (d) Capital gains proposed on non-residents (presently not taxable by treaty) should be reviewed. Normally such gains are taxable by the non-resident's country and in effect the Canadian proposal is to divert the tax to Canada from the treasury of the non-resident's country. It could only be expected that reciprocal arrangements would apply even if the treaties can be renegotiated. (e) That a more liberal system of income averaging be allowed, possibly on lines recommended by the Royal Commission on Taxation. The White Paper proposals are minimal and should be expanded to be of any real value. (f) With the introduction of capital gains taxation, estate taxes (and provincial succession duties) should be reviewed and modified perhaps by reducing such taxes on capital over a transitional period.

Name: GULF OIL CANADA LIMITED

Principal Subject: Goodwill and other Non-Depreciable Expenditures.

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not classify amounts paid for Goodwill as a depreciable asset.	5.4 There is a class of expenditure incurred by businesses that is not deductible, either in the year in which the expenditure is incurred or over a series of years. The taxpayer is prohibited from deducting them in the year in which they are incurred because they are capital expenditures. He is prohibited from deducting the cost over a number of years by way of depreciation because they do not give rise to an asset for which provision is made in the depreciation regulations. Perhaps the best known of these capital nothings is goodwill. If a Canadian buys a business, he can neither deduct nor depreciate the portion of his purchase price that relates to the goodwill of the business. 5.5 The government proposes to create a new depreciation class which would sweep up all of these nothings and which would enable the taxpayer to deduct 10 per cent of the book value of this class each year. We believe that the 10-per-cent rate is fair if one takes into account the type of expenditure to be included.	Pages 35 and 36 of the brief. This portion of the brief states: Gulf Canada, therefore, proposes that purchased goodwill should not be put in the "nothings" class and depreciated but that when the underlying assets are sold, any loss or gain be treated the same as any other capital gain.

[illegible]: GULF OIL CANADA LIMITED

Principal Subject: Goodwill and other Non-Depreciable Expenditures.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.6 This proposal would be impossible without a tax on capital gains. For as long as the proceeds of the sale of goodwill, among other things, remained tax-free, it was impossible to give a deduction for the cost of purchasing goodwill without creating a leak in the tax system. This leak would cost significant amounts of revenue even under ordinary commercial practices, and the revenue loss would be greatly increased as a result of taxpayers arranging their affairs to take maximum advantage of the situation. 5.7 The goodwill of a business has been described as the value that can be placed on the fact that customers are more likely to trade with that firm than with a new firm in the same line. This likelihood arises in part as a result of advertising and in part because customers have been satisfied in their past dealings with the firm. Clearly, goodwill is a thing that must be kept up. If a firm stops advertising or if it stops giving satisfactory service, its goodwill will disappear. Therefore, the goodwill that a firm has now is the result of its past actions, and the goodwill that it has five years from now will be the result in part of its past actions and in part of its actions in the next five years. The government proposes to recognize this fact in the treatment of taxpayers who sell goodwill in the future. The longer the period after the beginning of the new system before the sale takes place, the more of the proceeds of sale that would be taxable and the smaller the part of the proceeds that would be exempt.	

Name: GULF OIL CANADA LIMITED

Principal Subject: Goodwill and other Non-Depreciable Expenditures.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.8 Another fact must be taken into account in setting the treatment of early sales of goodwill: purchasers would be willing to pay more for goodwill under the proposed system (since they can deduct the expenditure for tax purposes over a period of years) than they are willing to pay under the existing system. With these factors in mind, the government proposes that taxpayers who sell good-taxable on 40 per cent of the proceeds and exempt on 60 per cent; if in the second year, taxable on 45 per cent and exempt on 55 per cent; and so on, with the taxable portion increasing by 5 percentage points each year until the thirteenth year when 100 per cent of any proceeds would be taxable. Naturally, if a sale of goodwill involves a business that was not in existence when the new system commences, all of the proceeds would be taxable even though the sale takes place before 12 years have passed.	

Name: GULF OIL CANADA LIMITED

Principal Subject: Capital Cost Allowances on Rented Buildings

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act places no restrictions on capital cost allowance claims on rental properties.	5.16 Many taxpayers who would otherwise be in quite high tax brackets have become landlords, and have been able to reduce or eliminate the tax on their other income by claiming the maximum depreciation on their buildings. Ideally this early generosity should be offset by lower depreciation deductions in later years, or by recapture of the extra depreciation on sale. However, if the taxpayer buys additional buildings—and with the relatively low down payments required, this can often be done out of the tax savings alone—he can postpone almost indefinitely the day when his total depreciation deductions will drop below average. Moreover, since most of the buildings concerned are in the same class, a taxpayer who sells a building can avoid recapture of the proceeds by investing them in another building. Finally, if the taxpayer continues this process throughout his life, the tax postponed becomes tax saved forever. When a taxpayer dies, excess depreciation is not recaptured, and the person who inherits the buildings is entitled to depreciate the full fair market value of the buildings, no matter what net book value his predecessor had.	Pages 36 and 37 of the brief. This portion of the brief recommends: Gulf Canada, therefore, proposes that the application of the provisions outlined for tax treatment of rental buildings costing $50,000 or more and the holding of property be clarified to ensure they do not apply to bona fide operation of industrial and commercial corporations.

Name: GULF OIL CANADA LIMITED

Principal Subject: Capital Cost Allowances on Rented Buildings

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	

Name: GULF OIL CANADA LIMITED

Principal subject: Capital Cost Allowances on Rented Buildings

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.18 Because the depreciation rates are based on averages, they sometimes turn out to be inadequate. Indeed, as the royal commission pointed out, there are instances in which the net book value of a class of assets becomes greater than the cost of the assets that the taxpayer has on hand at the time. This arises, of course, because the depreciation he has been permitted was not as great as the actual depreciation suffered on some of the assets which he has since sold or scrapped. This problem would disappear in the case of rental buildings which cost more than $50,000 as explained in the previous paragraph. However, it would remain for other assets. Consequently the government proposes that taxpayers be permitted at any time to write a class of assets down to the aggregate cost of the assets of that type still on hand.	

Name: GULF OIL CANADA LIMITED

Principal Subject: Entertainment and Related Expenses

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act permits the deduction from income of reasonable amounts of business promotion expenses.	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars. 5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.	Page 37 of the brief. This portion of the brief states: Gulf Canada believes the government is taking a most extreme position in denying all deductions because they have found some abuse. The legitimate expenses (conventions, certain entertainment, etc.) are a proper cost of carrying on business and should be allowed. Certainly, industry generally through their own internal check procedures, control such expenditures usually to a more stringent level than the tax assessor might deem necessary. Gulf Canada believes that the present Income Tax Act contains provisions which are adequate to control any abuse and is of the opinion that, rather than the government adopting such sweeping and harsh measures as those proposed to assure that no abuse exists; departmental practice should be tightened under existing legislation. If the government does not accept that "tightening up" will be sufficient, Gulf Canada proposes that guidelines be established and made part of the regulations. Such guidelines could be based on the United States Internal Revenue Code, Section 274 but it is hoped that any guidelines that are developed will require only minimum record keeping to ensure administrative compliance.

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 22

THURSDAY, MAY 7th, 1970

Sixteenth Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 22 : 5)

APPENDICES:

"A"—Brief from James Richardson & Sons, Limited.

"B"—Analysis of Appendix "A" by Senior Advisor.

21891—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(29)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The Question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

21891—1½

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

Thursday, May 7th, 1970.
(32)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Carter, Flynn, Everett, Gelinas, Haig, Hays, Hollett, Isnor, Macnaughton, Molson, Phillips (*Rigaud*) and Welch—(17).

Present, but not of the Committee: The Honourable Senators Laird, Smith, Sparrow and Urquhart—(4).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor; R. Breton, Executive-Secretary.

The following witnesses were heard:

James Richardson & Sons Limited.

Mr. G. T. Richardson, President;
Mr. G. Lawson, Senior Vice-President;
Mr. N. J. Alexander, Vice-President, Managing Partner, (Richardson Securities of Canada);
Mr. F. N. Hughes, Deputy Managing Partner, (Richardson Securities of Canada);
Mr. J. T. Ellis, Treasurer;
Mr. F. J. Lamont, Secretary and Counsel, (Richardson Securities of Canada);
Dr. E. W. Clendenning, Economist, (Richardson Securities of Canada);
Mr. P. Burrage, Information Officer.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from James Richardson & Sons, Limited.
B—Analysis of Appendix "A" by Senior Advisor.

At 11:30 a.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

ERRATUM: In the brief submitted by Elgistan Management Limited as printed in Issue No. 14, dated Wednesday, April 8th, 1970, two typographical errors occurred as follows:

On page 14: 121, the third main paragraph of Section II reads "It is worth nothing . . .", whereas the brief read "It is worth *noting* . . .".

On page 14: 124, the 10th line from the bottom of the first column reads "White paper assets . . ." whereas the brief read "White Paper *asserts* . . .".

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, May 7, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: We have one submission today from James Richardson and Sons Limited. Mr. Richardson is going to make an opening statement, and present his panel. We shall then go on and deal with the different headings in the brief, during which the panel will be subject to questioning.

Mr. G. T. Richardson, President, James Richardson & Sons Ltd.: Mr. Chairman and Honourable senators, we appreciate very much this opportunity to appear before your committee to discuss the brief which has been submitted on behalf of James Richardson & Sons, Limited and its associated enterprises. We particularly appreciate the co-operation which we have experienced in scheduling our appearance, so that it has been possible for a number of my associates to attend today with the view of putting their knowledge and experience at the disposal of the committee. Mr. Lawson is our senior vice president; Mr. Alexander, a vice president of James Richardson & Sons, Limited and Managing Partner of Richardson Securities of Canada. Mr. Hughes is Deputy Managing Partner of Richardson Securities of Canada.

The committee which was appointed to assess the White Paper is represented here by Mr. Ellis, our treasurer; Mr. Lamont, Secretary and Counsel to Richardson Securities, and Dr. Clendenning, Economist of Richardson Securities. Between those who are present today, we hope to be able to answer any questions you may have on our brief, and to expand upon certain aspects where some of us may have relevant knowledge.

The White Paper, "Proposals for Tax Reform", is a complex document with far-reaching implications for the economic environment of Canada. We concluded that it was desirable that a searching analysis of the proposals be made and to that end, a committee of senior personnel was assigned the task of studying the proposals individually and as a whole. Their terms of reference were the common interests of Canadians, and not the interest of any group or segment. In the application of those terms, the committee has had a free hand.

This committee met daily for a period of many weeks debating the concepts of the White Paper, consulting at its discretion with others, including economists and groups studying particular areas of the proposals. This study indicated that while the immediate tax effect of the proposals as such was favourable to the interests of the proprietors of the firm, they concluded that many of the proposals were not in the interests of Canada and were not, in fact valid. Their conclusions have, of course, been reviewed in detail by our senior executives and we concur with them.

The White Paper has some important and desirable features: relief from double taxation of corporate earnings, relief at the lowest level of personal income, reduction of the higher rates of personal tax, and provision for child care expenses. However, the core proposals are built around the related proposals of a 50 per cent corporate tax rate, and a maximum 50 per cent personal tax rate, with flow-through related to creditable tax. Whatever attraction these proposals have in themselves their adoption would be the source of serious difficulties of transition and administration and they cannot be considered permanent. Adjustment of personal or corporate rates upwards or downwards undoubtedly will be required by public policy and it is extremely unwise to build the whole tax structure on the assumption of the permanence of these rates.

Provincial requirements destroy the 50 per cent-50 per cent concept at the outset, without considering the growing revenue needs of provinces to discharge their constitutional responsibilities.

Ultimately, foreign competition will destroy the 50 per cent corporate rates because of different corporate

tax rates and structures. For example, the United Kingdom has 45 per cent, United States is moving towards 48 per cent, Japan has 35 per cent, Germany a varying rate depending on distribution. Should value added taxes be adopted by the United Kingdom or the United States wholly or partly in substitution for corporate income tax, the 50 per cent corporate rate in Canada cannot be sustained.

Our rates of corporate tax must be competitive with world rates and we cannot afford to adopt a system of taxation which takes five years to mature and which is obsolete before we start.

The proposals approach the taxation of corporate source income by a flow-through of tax paid, thus causing a destruction at the shareholder level of any incentives which may be built into the tax system.

It appears probable that substantial economic effects will be occasioned by the combined effects of the restructuring of the tax system and the large tax increase. It cannot be prudent to implement a massive change in structure without realistically assessing its economic effects. It cannot be prudent to shift substantial additional resources to the public sector without indicating and justifying the purposes for which the funds are to be used.

The capital gains proposals have very considerable problems which we discuss in our brief and which we hope to amplify today. The problems stem from the core proposals on shareholder and corporation.

The Government of Canada, and in particular the Prime Minister, has requested constructive criticism of the proposals, but the Minister of Finance seems receptive for peripheral changes only. He has, for example, indicated flexibility on capital gains on homes, some modification of the five-year revaluation, and concessions with respect to business expenses.

But, the proponents appear to be adamant with respect to the core proposals: closely and widely-held companies, gross-up and creditable tax, the rigid 50 per cent-50 per cent concept, and the related capital gains proposals.

These areas are the most complex and difficult in the White Paper and relatively few people have had an opportunity to evaluate these proposals. They are too complex to be readily assessed by those who will be affected.

In our opinion, they are unnecessary to the reasonable objectives of reform and in many respects, they are unworkable.

In our brief, we have made constructive criticism and recommended some solutions. Many of the worst features of the White Paper do not have significant revenue implications, and it is not necessary for us to make quantitative assessments which would be beyond us. We have, however, made some suggestions which would conserve revenue.

Mr. Chairman, with your permission, we would like to review a number of the topics within our brief, Mr. Lamont will cover Corporation and Shareholder; Mr. Ellis, Capital Gains; Mr. Hughes, Mining and Oil and Capital Markets; and Dr. Clendenning, Personal Income Tax, Mr. Lamont will cover a few items which we believe to be important but which are not part of the "core" proposals, and, finally, Dr. Clendenning will speak on Economic Impact. This review without questions, would take about 50 minutes, but we would welcome questions at any stage, and in this respect put ourselves in your hands.

The Chairman: Honourable senators, we will proceed in this fashion and then, as questions present themselves, we will go into the question and answer method.

Mr. Lamont?

Mr. F. B. Lamont, Secretary, Richardson Securities of Canada: Mr. Chairman and honourable senators:

We believe that many of the massive problems relating to both the introduction and continuing administation of the proposals stem from the concepts applicable to corporations and shareholders.

The White Paper proposes the introduction of a conceptual framework which is radically different from the present (and from other major tax systems).

We question the adoption of this radical conceptual framework when it appears to be founded upon false appreciation of the nature of corporation income, false assumptions as to the structure of corporate enterprise and unrealistic assumptions as to the permanence of rate levels whether personal or corporate.

We believe that the introduction of this conceptual framework will occasion great uncertainties as loopholes appear and are closed. The present tax structure may require modification, but is not, as suggested in the White Paper, rife with loopholes.

We believe that it is this framework which causes many of the difficult problems of transition and administration and that this framework is in no way essential to the reasonable objectives of reform.

We believe that an extension of the present tax structure using the dividend tax credit and capitalization of corporate surplus presently permitted in the

act can accomplish the purpose of the White Paper with respect to the closely-held companies, without relating corporation tax paid to the tax of the shareholder or imputing the income of the corporation to be the income of the shareholder.

Corporation income should be taxed on a realistic basis and corporate distributions should be taxed on a realistic basis.

It is desirable to recognize the general contribution that is made by corporations in the tax treatment which is afforded to corporate distributions to shareholders; but the proposal to precisely link the shareholder with the corporate tax paid, along with the necessity to distribute income within two and one-half years to obtain the gross up and credit causes the gravest distortions and complications.

(a) In portfolio management for income the investor needs to be able to predict as nearly as possible what the income consequences to him will be. To do that he or his advisors will assess the gross income likely to be forthcoming based upon contractual commitments and projected dividend policies. Many investment grade dividend paying companies are in cyclical industries whose investment quality has been attained through strong financial management and regular dividends. The investor would be expected to assess not only the long-term strength of the company in relation to its established policies, but also its year-to-year position on its income tax, a task the company itself would find difficult. This problem extends to companies in many industries, in which by reason of incentive, capital cost allowance or other feature of the Income Tax Act, the corporation will be paying dividends during periods when there may have been no corporate tax paid. If there is a problem here, surely it is between the corporation and the tax authorities, and the shareholder ought to have no part of it.

(b) The next absurdity which results from this proposal is the creation of a tax on inter-corporate dividends which cause considerable complexity, particularly where dividends may flow through both closely-held and widely-held companies. The normal case presumably would be for no tax to be eligible.

(c) Another difficulty raised by this aspect is discrimination against corporate income abroad. We believe that there are other social and economic objectives to the promotion of Canadian enterprise than the generation of revenue for government. Certain Canadian companies and industries have developed skills and expertise which can be usefully employed abroad, in providing useful contributions to the economic welfare of the foreign country. In other cases, foreign operations may be an essential complement to the operations of the Canadian company in Canada.

(d) The gross up and credit approach will also result in the anomalous position that the tax structure or government policy will create incentives for the corporation to undertake an activity or to locate it somewhere while the incentive will be swept away at the shareholder level. It seems pointless to begin with and contrary to the apparent identification of shareholder with corporation. If the government considers it to be good for the corporation, why is it bad for the shareholder? If a particular enterprise were undertaken on a partnership basis, the incentive presumably would flow through to the persons undertaking the enterprise. If incentives are necessary or desirable, it is more intelligent to flow through the incentive rather than flow through the tax.

(e) Another effect may be the distortion of dividend and capital patterns in order to pass on creditable tax to shareholders before it expires. Forced distributions would create serious conflicts of interests between shareholders. If the problem were attacked by stock dividends, this would create difficulties for the high income shareholders since there would not be cash received to pay tax. The tax incentive to distribute earnings would diminish capacity to reinvest income at points of high growth potential.

The proposals with respect to "closely-held companies" are in many respects favourable to their shareholders but there are a great many problems and inequities which arise in the transitional period—the retroactive aspects on the taxation of capital gains, the distribution of earnings within the two and one-half years among them. They result primarily because of the identification of company and shareholder.

The proposals would have the effect of seriously discriminating against the shareholders of certain utility companies or other companies which do not now or may not in future pay federal tax. The proposals make equity financing of these companies in Canada extremely difficult.

Finally, it is this concept which makes it particularly difficult to provide any fiscal incentives to small businesses.

There appears to be some suggestion in the White Paper proposals that the corporate tax credits for provincial and federal purposes would be separate. If this is so, the results would be even more complex and arbitrary than appears at present. Would corporations allocate or be required to allocate the provincial tax

paid among the provinces? The calculation of after-tax income per shareholder would be very difficult and its estimation in advance simply impossible.

Many of the most serious and arbitrary consequences in the proposals arise from the gross-up and credit approach to the corporation and its shareholders. The approach should be abandoned and the reasonable objectives of this approach should be attained through a lowering of tax on corporate distributions.

Part of the logical structure supporting the gross-up and credit appears to be the maximum personal tax at 50 per cent and the uniform corporation tax at 50 per cent. It is completely impractical to consider either personal or corporate rates to be permanent. The Carter Commission made assumptions as to rate requirements which were quite out of date by the time the report was published. The White Paper proposals in terms of rate are obsolete at the beginning and yet the rigidity of the rate structure appears to be an essential part of the package.

The maximum personal rate of 50 per cent seems unrealistic in view of provincial fiscal requirements.

We find it impossible to rationalize the distinction made in the White Paper between closely-held companies and widely-held companies, certainly not in the area of competition. The larger grain companies for example, include public investor companies, private companies, American-owned companies, three wheat pools and a farmer-owned public company. Canada's largest retailer would be closely-held, but competes with publicly-owned Canadian department stores, a well-established public company incorporated in England and with most major retailers in the cities in which it does business.

We do not believe the proposed distinction in classes of companies can be justified. The problems of closely-held companies relate to the need to withdraw surplus at reasonable cost to make provision for orderly transfers of ownership of enterprise and to make provision for estate tax liabilities. The problems should be resolved on the distribution of corporate surplus.

The Chairman: This seems to be a good place for some questions. There is a wealth of material in what Mr. Lamont has said.

Senator Phillips (Rigaud): Mr. Chairman, it might be more helpful in this particular instance if we were to hear all the briefs first so that we could get the continuity.

The Chairman: If that is agreeable, honourable senators, I will ask Mr. Ellis to make his presentation concerning capital gains.

Mr. J. T. Ellis, Treasurer, James Richardson and Sons Limited: Thank you, Mr. Chairman. Honourable senators, the capital gains proposals are based upon the concepts set out in relation to corporations and shareholders. We have indicated some of the difficulties in these concepts and we believe them to be unsound. If we discard the corporation shareholders approach put forward in the White Paper, we are free to examine the taxation of capital gains on its own, taking into account its position in the overall fiscal structure but recognizing specific problems.

We accept the taxation of capital gains as necessary to complement other parts of the tax structure, but to be accepted as fair the basis of taxation of these gains should be a separate part of the income tax structure and at lower rates than the progressive rates on other income.

We believe that capital gains cannot be treated the same as ordinary income. Some aspects which distinguish capital transactions are their relative infrequency, size in relation to income flows, the optional nature of realization, and the fact that their realization is not usually directly related to consumption expenditures. The question is what kind of taxation, if any, is suitable in order to achieve reasonable equity, achieve economic efficiency, protect the revenue, encourage investment and conserve saving.

Since our present system exempts capital gains from tax, we can approach the actual rate to be applied with a relatively open mind.

Provided that a reasonable balance can be obtained between the other objectives, we believe that the rate to be applied should be one which would not distort economic decisions. The evidence of United States experience is that the maximum rate of 25 per cent creates "lock-in."

Indeed, the proposal to apply five-year revaluation concedes that such an effect would exist and be substantial. The taxing of other capital gains at full income rates will be even more significant.

In our opinion a rate of about 15 per cent would be the maximum that would be accepted without significant distortion.

We think that such a rate would minimize the disparity between those who realize gains and pay tax and those who do not and enjoy the increment

through, for example, increased income flows. In our opinion it provides reasonable equity with ordinary income for two reasons: first, that full–or half–offset of capital losses cannot be given against income because the revenue effect could be disastrous; secondly, the risking of capital differs in kind from regular income flows.

By their nature, gains on the disposition of assets arise by the transfer of savings. The conservation of savings is desirable and the mobility of capital which such a rate would permit would also contribute significantly to the advancement of our economy.

Paradoxically, we believe that a rate of 15 per cent would, in fact, create more revenue than a higher rate, and although this would reduce savings, the increase in economic efficiency could in our opinion outweigh the direct loss of savings. The kind of effect which we foresee is the freeing of venture capital which would be available for investment in high-risk situations. If the venturer can liquidate his commitment at reasonable tax cost he can pass on ownership to investors who are necessarily more conservative. If the liquidations result in excessive tax cost, the venturer may retain his position and take dividend income. Since there is a limited supply of capital for this type of investment its immobility as a result of the tax environment would be particularly unfortunate.

Our decision on rate is necessarily a matter of judgment, but it is considered judgment. By introducing a relatively "neutral" rate of tax on capital gains we would have an opportunity to assess it over a period of time. In particular, it would give us an opportunity to compare our experience with other countries, for instance, the United States. The rate of taxation on capital gains should probably bear some relationship with rates on corporate distributions. The White Paper, in effect, proposes rates of nil tax and 25 per cent tax on corporation distributions compared with a 16-2/3 per cent or 15 per cent rate presently applicable on the capitalization of corporate surplus. A 15 per cent rate on distribution of surplus and a 15 per cent rate on capital gains would make the realization of gain by the distribution of surplus or the sale of shares equivalent.

The manner of impact of capital gains tax as it applies to an estate appears to be extremely arbitrary and may result in extraordinarily high rates of tax upon an estate. It is obviously unsatisfactory if the tax implications on realizations of gains in relation to the date of death create substantially different tax treatment. The imposition of a tax in capital gains requires substantial modification of the estate tax structure.

We would suggest that capital gains be deemed to be realized upon death, and tax deducted from the estate for calculation of estate tax. This would neutralize the timing of realization. At the same time, maximum estate rates should be reduced so that the total estate tax burden and capital gains tax would not exceed the present burden. This would result in a much fairer incidence of tax as between estates of the same size and remove one disincentive to realize upon capital gains. It would also remove a serious inequity as between estates, which would have to realize, to pay estate taxes or distribute property, and those which would not.

The Chairman: Next we have Mr. Hughes on Mining and Oil.

Mr. F. N. Hughes, Deputy Managing Partner, Richardson Securities of Canada: Mr. Chairman and honourable senators; In the natural resource area two very different industries with different problems of exploration, development, capital and marketing have been linked together for tax purposes. This is unrealistic. The financing of production of proven oil reserves is normally much simpler than financing a new mine.

Many countries in their taxation policies have recognized that, due to the high risks and large amounts of capital employed, these industries cannot be treated on the same basis as other industries. Canada has, for a number of years, been one of the countries that recognizes these factors and, as a result, these industries have made an immense contribution to the economic development of Canada, particularly in the last twenty years. It is unrealistic to take a theoretical approach to their present tax position and claim that they are capable of producing more tax revenue, whereas it is very likely that they would not have existed in their present form, and be making their present important contribution if they had not been provided with incentives. In the last few years, even with our present incentives, other countries such as Australia, have been competing with Canada to attract mining investment. Any drastic change in our tax approach could well lead to a larger percentage of this development capital being attracted elsewhere.

Many of the economic effects of the White Paper are incalculable because there would be conflicting influences affecting decisions, and the estimate of the final direction and size of change would simply be arbitrary. However, the effect of the direct changes in mining are essentially adverse and are more susceptible to measurement than most. In the White Paper, no serious attempt has been made to estimate it other than to assure us, "We do not expect it to be serious".

One intelligent question might be whether the changes would produce more or less revenue than at present. A detailed economic study examining new mines brought in over a period of years applying cash flow projections under the new proposals to the feasibility studies actually employed for decisions would be useful though, of course, it could not measure the effect of the proposals on exploratory effort.

The gross up and credit proposals effectively remove the benefit of the incentives which were thought necessary to promote activity.

The Chairman: Mr. Hughes, you are also dealing with capital markets?

Mr. Hughes: Yes, Mr. Chairman.

The Chairman: Would you like to proceed then?

Mr. Hughes: The proposals intended to favour Canadian investment in Canadian equities would cause distortions in our capital markets. In some cases these distortions more than off-set the incentives provided.

The flow-through and gross-up proposals would cause a shift in the rates of return (after tax) between Canadian and foreign equities and within the Canadian equity market itself. Canadian investors would prefer dividend-paying fully taxable Canadian corporations and would bid up the prices of these equities. I think this is quite apparent from what happened the day after the White Paper was announced.

The prices of non-dividend and/or non-taxable Canadian equities would fall relative to other equities, and would become attractive to foreigners (who would not be eligible for the proposed creditable tax and would not be taxable on capital gains if they held a less than 25 per cent interest). As a result, control of the rapidly growing and more dynamic corporations could pass to foreigners while Canadians shifted to the more conservative type of equities. This would be especially true in the case of natural resource companies which would not be paying full taxes because of incentives provided by the taxation system.

In effect, a foreign shareholder would be able to receive the benefit from tax incentives granted to a Canadian corporation which would be denied to a Canadian shareholder. This is in conflict with the proposals favouring Canadian investment by Canadians. If Canadians are to maintain and increase their ownership of the resources of the country, they must be left with the means and incentives to invest in the most dynamic sectors of the economy. The flow-through and gross-up proposals would achieve the opposite result.

There is a rather narrow limit in Canada to the amount of capital and the number of investors available to provide the risk capital for new or developing ventures. The whole thrust of the White Paper is to encourage this capital and these investors to become "locked in" to situations after they have reached a more mature stage. If the proposals were to be adopted in their present form, it is very likely that the supply of this type of capital will drastically shrink in Canada and the new and developing situations will be forced to go outside of the country for their capital requirements.

The proposal to revalue holdings of widely-held shares every five years also causes many problems in the capital markets. The problems for the controlling shareholder are obvious. The public has a substantial interest in stability of control of corporate enterprise. As underwriters, Richardson Securities of Canada is aware of the necessity of securing stability of control and stability of management for issues which are offered to the public. The management for issues which are offered to the public. The securities commissions are also concerned with this aspect. Furthermore, shareholders whose holdings "may materially affect control" may only distribute their stock through an offering by prospectus filed and accepted by the relevant securities commissions.

The proposal to tax so-called gains without realization is grossly discriminatory relative to other assets. Particularly is this so for controlling shareholders who have gone to public markets, as opposed to "closely-held" situations, where the proposed income tax situation would be more favourable.

If it is eventually accepted that controlling shareholders must be exempted, it is difficult to see why the public investor should be singled out for revaluation. It is unsound to consider as income, gains which have not and may never materialize.

The discrimination proposed between closely-held and widely-held companies as to current income tax treatment, taxation of capital gains and revaluation would discourage the flow of new issues by able entrepreneurs who could effectively use capital from the public.

The revaluation proposal would very definitely discourage the sale of minority interests to the public; while the preferential capital gains treatment accorded to gains on widely-held shares would encourage closely-held companies to go public if the owners were selling their entire holdings. The decision whether or not a company should go public should be made on economic grounds and not be based on tax considerations. The proposals in the White Paper will have the

effect of cutting off the flow of new equities to the capital markets, and prevent the further broadening of the Canadian equity market. The stock market in Canada is now very narrow in many industries and the discouragement of new issues will only accentuate this situation.

The proposals with respect to losses do not appear to have taken account of the potential impact of capital losses on government revenues or distortion to the capital market in the event of a sharp market decline. Even with the limitation of losses applicable in the United States, substantial market impact is felt through the realization of losses during the latter part of the year. If half the losses could be set off against personal income this would cause, in our opinion, more serious distortion to the capital market during periods when the market was already depressed and a substantial reduction in personal tax receipts. This could be particularly true during the five-year run-in period when effective tax rates as high as 45 per cent exist. The tendency would be to take the losses during that period, if at all possible, and not to take any gains.

In some provinces the taxation of bonds and debentures at full income rates, and complete deduction of losses could occasion even more catastrophic effects upon government revenues during periods of declining markets. This is particularly so since the revision of portfolios could be accomplished with actual realization of securities and replacement with different bond issues of equivalent quality, yield and maturity. In other words, holders would be able to bunch their losses and spread out their income.

The total value of federal, provincial, municipal, corporate and institutional obligations in Canada is about $55 billion, excluding Treasury Bills and Canada Savings Bonds. While most of these holdings would be in institutional hands and many of the issues would, by reason of coupon rate or maturity, not be subject to great fluctuation, it is noteworthy that some of the Government of Canada issues declined as much as 14 per cent during 1969. The effect of tax loss selling by individuals during periods of tight money could cause serious distortions, and could cause very substantial offsets against taxable income, even if the percentage of securities held by individuals was relatively small. The resulting pressure on the bond market could occasion support from the central bank which might be contrary to monetary policy.

The differential dividend and capital gains treatment accorded to foreign equities could cause a reflow of funds into the Canadian equity market by mutual and pension funds and cause distortions in the market by substantially increasing the demand for the limited supply of investment grade shares of companies which pay dividends and are fully taxable. On the other hand, other risk capital may become locked into the U.S. market because of the punitive capital gains treatment and may not return to Canada to finance new undertakings.

This would mean that foreign investors would sell their holdings of high grade Canadian shares to Canadians and perhaps reinvest in the more dynamic Canadian corporations which would not be as attractive to Canadians because of the flow-through proposals; while a substantial volume of Canadian risk capital would remain in the U.S. market rather than returning to Canada.

The proposal to force pension plans and retirement savings plans to invest 90 per cent of their assets in Canadian securities also carries other implications.

There are many sectors of industry which are not represented by Canadian securities. For pension fund or retirement fund trustees to maintain a balanced portfolio they should have the flexibility of being able to invest in foreign securities. Foreign holdings will not usually be large because the withholding tax provides a bias towards Canadian securities. Further incentive should be unnecessary.

If the proposals were adopted, trustees representing millions of Canadians would be prevented from taking steps to protect the assets of their funds at times when the Canadian market was dropping. Furthermore, by locking these assets into Canadian securities a stabilizing factor would be removed from the market place.

The adoption of valuation day as the cost basis for taxation of gains creates serious problems of equity.

The market does not measure value for large blocks of stock even in actively traded securities. In other cases the market is not broad enough to absorb substantial volumes of shares. The market is, in any event, a measure of value only for the willing buyers and sellers at that price and then only if their holdings could be sold at that price.

A reasonable approach respecting the taxation of gains on shares would be to tax only from acquisition cost or value on valuation day, whichever is higher, and to allow losses only from acquisition cost or value on valuation day, whichever is lower. We note that the United Kingdom capital gains tax accepted cost or value on the date of introduction, whichever was higher, in order to avoid retroactive taxation of gains or taxation of the recovery of losses.

The proposal to tax gains on bonds at full rates has been mitigated somewhat by subsequent statements but ignores the very depressed market for bonds and ignores the fact that active investors in the bond market will have already adjusted their portfolios in order to improve term and yield. These investors will have suffered current losses and will be entirely taxed on the recovery of these losses. Since there is a substantial capital risk in bonds, a capital gains tax treatment for these securities is appropriate.

The Chairman: Now we have Personal Income Tax. Dr. Clendenning?

Dr. E. W. Clendenning, Economist, Richardson Securities of Canada: The combination of the corporate and personal tax proposals involves a structure which lacks the flexibility which a realistic fiscal approach requires. Mr. Bryce, as reported in the Financial Post of April 4th, had indicated that the new system would impose a greater burden of responsibility on Parliament to judge what real rate of tax can be imposed without serious economic effect. He indicated that this was the basis of the "difficult and controversial proposals in the White Paper to limit the top rates of personal tax in the neighbourhood of 50 per cent, about the same level as the standard rate of corporate tax". If Mr. Bryce is correct, and in this respect we believe he is, this is an important argument against the introduction of the proposals.

Senator Phillips (Rigaud): That is an interesting admission about Mr. Bryce.

Mr. Lamont: It is a limited admission, senator.

Dr. Clendenning: An examination of our present rate structure and sources of income tax paid indicates the most heavily burdened sector is the middle class. In 1967 the 6.7 per cent of taxpayers in the $10,000 to $25,000 income class produced 23 per cent of the revenue from personal income tax. The White Paper proposes to extend the net of the tax gatherer as it affects this heavily taxed but productive segment of our society and to increase the rates of tax applied to a broadened definition of income. This, we feel, would have a significant impact on private savings and a serious detrimental effect on personal incentive.

It appears that the rates of personal income tax at the lower levels of income are, in effect, lower in Canada than in the United States and that the level of social services in Canada is, in fact, higher than in the United States. At income levels above about $5,000, however, the burden in Canada is much higher. In Canada, then, it is the income between $10,000 and $25,000 a year which presently carries a very heavy burden not merely to assist the needy of our community but also to provide a significant subsidy to the average wage earner.

As a result, we believe that an important priority in tax reform should be a reduction in the rate of progression of personal tax rates.

The White Paper proposes a substantial increase in tax revenue and it is possible that this increase need not be as great and should be reduced enough to permit an easing of the proposed personal tax rates on all levels of income instead of on the lower half and upper 1 per cent of taxpayers.

One area where revenue might be made is by eliminating the so-called employment expense allowance of 3 per cent of employment income up to $150. A general allowance to everyone does not remove the injustice suffered by employees with real employment expenses.

A similar area is the standard deduction for charitable and medical expenses which operates as an increase in exemption for those who do not have these expenditures, discourages the smaller contribution to organizations such as the United Way, and discriminates against those who do contribute.

The White Paper also recognizes an important problem with respect to child care expenses, and we welcome this proposal.

The changes in the rate structure are proposed to be immediate as far as all aspects other than the lowering of the maximum rate which is to be reduced to 50 per cent over five years. There are compelling reasons to establish the new upper rate coincident with other changes.

The White Paper proposes to treat scholarships and bursaries as taxable income. This suggestion has some appeal to logic but it is another example of the preparation of the Paper without reference to the context in which we find ourselves, both as to the source and nature of this kind of income and the treatment afforded this income in other countries.

The tax relief which has been proposed at the lower levels of income sounds attractive but it is very minimal for those persons who receive it and at the same time, very expensive in aggregate revenue lost. It would be desirable to have an analysis of the persons who would be receiving relief, under these proposals and to discover whether a more effective device of providing relief for real need could be found which would not require the further escalation of personal tax rates.

Most of those who are receiving some tax relief must be in the category of persons with part-time employment, second incomes in the family, or single people just entering the labour force. The people who really need assistance are probably not paying any tax now.

It appears to us that the requirements of provincial governments with their related municipal responsibilities will destroy the structure of the system by increasing the rates of tax on personal income. The provinces do not share significantly in the substantial proposed increase in tax. The bulk of the increase goes to the federal government. The personal tax changes narrow the base of provincial revenue and as personal incomes rise, more of the increase in revenue will be retained by the federal government. The necessity for applying provincial rates as a percentage of federal rates increases the progression upon personal incomes. The combination of the integration proposals and provincial requirements will cause serious problems for persons who have high imputed incomes over which they have no control and we may have competition, for instance, between provinces.

The Chairman: The next heading is: Problems not Related to the 'Core' Proposals. Mr. Lamont?

Mr. Lamont: Yes, Mr. Chairman. A number of the peripheral recommendations reflect an unreasonable obsession by the authors of the White Paper with possibilities for tax evasion, so much so that a number of these proposals would have the effect of imposing serious injustices upon the general taxpayer, in order to eliminate a real or imagined abuse applicable to a very few taxpayers.

An example of this is the proposed denial to taxpayers in the professions to report their income on a cash basis which will remove "an unwarranted advantage by comparison to the rest of Canadians." Since the vast majority of Canadians pay tax upon a cash basis, it is difficult to see the validity of this argument. It has been suggested that the real abuse which is thought to exist here is where a person in a profession is in a position to control the payment of his fees, the liability of the fees may be accrued by the client without a corresponding income receipt by the professional.

If this abuse exists, it hardly seems necessary or desirable to inflict substantial injustices upon all self-employed members of the professions in order to cure an abuse which can only affect a very small percentage.

With respect to entertainment and related expenses, the present Income Tax Act permits a deduction only insofar as the expenses are reasonably laid out for the production of taxable income, which would seem to provide sufficient scope to correct any abuse (which presently exists and which cannot be substantial). The proposal to disallow them can again be categorized as a proposal to inflict an injustice on the many to cure an abuse of the few.

The proposal with respect to trusts seem to have been put forward to cure abuses which are not known but which the authors feel might exist. As they admit that "less is known to the use of which trusts are put in Canada and given the varied uses that are possible, it is difficult to foretell all the effects of the proposal."

The withholding tax proposal of 25 per cent on pensions abroad is another example of an arbitrary levy presumably designed to block some loophole or other but which cannot but have the effect of imposing hardship, and perhaps substantial hardship, upon the considerable number of average Canadians who retire out of Canada for reasons of climate, living costs or family.

We believe that a capital gains tax on homes will occasion serious injustice, but the proposal is still advanced despite disclaims of revenue potential. This attitude seems explicable only by reference to the possibility that a real gain may escape untaxed, and thus it is intended to tax the many to catch the few.

One item which I did not have in my notes, but which falls in this category, is the proposed tax on lump-sum withdrawals. Mr. Benson's comments in the *Globe and Mail* this morning clearly put this in the category of a tax designed to catch the few, which is going to impose an injustice on many. It seems to be a philosophy which runs through parts of the White Paper.

The Chairman: The White Paper is a proposal in which loopholes are discovered. Therefore they have to go further in their proposals. They are closing loopholes which they create themselves.

The next heading is: Economic Impact. Dr. Clendenning?

Dr. Clendenning: Thank you, Mr. Chairman.

The tax changes proposed in the White Paper would, we feel, have a significant impact on the Canadian economy. In our opinion, the economic implications of the proposals have not been dealt with adequately and in some cases have been ignored altogether. Of particular importance is the impact on private savings and investment in Canada. If the proposals are to operate to stimulate or at least not retard economic

growth, their impact on these two vital areas of the economy must not be detrimental.

The proposals would reduce private savings and capital accumulation through:

(1) The imposition of a substantial tax increase on the high-savings sectors of the economy—the middle class taxpayers and corporations.

(2) The shift in the tax burden from the median to the middle class taxpayers.

(3) The taxation of capital gains.

(4) The removal of the low rate of tax on the first $35,000 of corporate income.

(5) The increased taxation of the extractive industries.

(6) The combination of high estate taxes and a capital gains tax.

Because of the adverse impact of the proposals on savings and capital accumulation we believe that steps should be taken to remove much of the increased tax revenues from the new system, and to reduce the anti-savings bias in many of the proposals. Many of our suggested changes are aimed at achieving this.

In general, we feel that there is a conflict between proposals that provide incentives for Canadians to invest in Canada and proposals which reduce the volume of private domestic savings or remove incentives for particular worthwhile types of investment.

In conclusion, then, we question the contention in the White Paper that the economic impact would be minimal. Because of the obvious detrimental impact on private savings and investment, it seems clear that the Canadian economy would not achieve a growth rate as high as it would have under the existing taxation system. This, we feel, is detrimental to the welfare and prosperity of every Canadian, whether he is a member of the lower, the middle or the upper-income group. The best way to improve the well-being of all Canadians is through the generation of a high rate of economic growth.

The Chairman: The formal presentation is concluded?

Mr. Richardson: Yes, Mr. Chairman.

Senator Phillips (Rigaud): Mr. Chairman, in view of the fact that Senator Everett will be forced to leave us at 10.30 for a meeting of the Standing Senate Committee on National Finance, I would suggest that we yield to him in respect of any questions he would like to put.

The Chairman: Senator Everett, would you like to proceed first?

Senator Everett: Thank you, Mr. Chairman.

With regard to your suggestion that the distribution of surplus of any corporation be available on payment of 15 per cent tax, could you tell me if that tax would be payable on the entire surplus of the corporation or, as it is now, on the undistributed income of the corporation, with capital surpluses, so-called, being free of tax?

Mr. Lamont: I think we would contemplate merely continuing the existing system, which refers solely to undistributed income. One of the advantages of continuing on this particular basis is that is provides continuity with the existing tax structure, so it would be undistributed income you are talking about.

Senator Everett: Undistributed income or all surpluses?

Mr. Lamont: No, undistributed income.

Senator Everett: What would happen to the remainder of the surplus?

Mr. Lamont: Presumably if there are other forms of surplus within the corporate structure as we go into the system, that would represent capital of the company and would be represented in the valuation of the shares of the company, and it would be just the base cost or base valuation for the proprietors of the firms.

Senator Everett: I am thinking of the sort of surplus that might result from a capital gain by the corporation.

Mr. Lamont: After the date of the introduction of the tax?

Senator Everett: Indeed yes, or before.

Mr. Lamont: If it is before, in my opinion it should be built into the value of the shares; since it is not taxable now, it does not form undistributed income. I would think—and this is one of the problems we have to deal with in the introduction of a capital gains tax—it would be desirable to have a capital gains treatment of the holdings of companies, such that it would not go into undistributed income but would form a capital surplus so as to avoid double and triple taxation of capital gains as it goes through corporate hands. But this is a detail that would have to be worked out in terms of introducing a capital gains tax.

Senator Everett: What sort of a distribution do you envisage? A complicated one or a very simple one?

Mr. Lamont: I do not think there is any necessity to have it of great complexity. I do not think the concern of those who are connected with the capitalization of corporate surplus at the moment is with the complexity, because they can get professional advisors to take the necessary steps. I do not think it is particularly difficult to get surplus out at say, $16^2/_3$ per cent or 15 per cent under the present income tax structure. Maybe it would be more difficult to try to get it out for nothing, but with 15 per cent, if it is practical it is not difficult. Certainly it could be streamlined within the act, but that is not an area in which we profess to be experts. Perhaps Mr. Gilmour would be able to add to that.

Senator Everett: Do you propose that this 15 per cent tax on the distribution of surplus would be available to all corporations?

Mr. Lamont: I do not see why it should not be. It is available to all corporations now. Public corporations rarely avail themselves of this, although it is not unknown that some companies have paid tax under section 105 and made tax-free distributions. I cannot remember what they are; there are two or three companies that carry out this policy, but . . .

Senator Everett: If I might interject there, you say it is available to all companies now. I am not as conversant with the Income Tax Act as you are but I thought there was some rule about 75 shareholders.

Mr. Lamont: I do not believe so.

Senator Beaubien: Mr. Gilmour says not.

Mr. Lamont: Is there? The point is that with a public company you cannot tell whether the shareholders will be better off by doing one thing or another.

Senator Everett: Indeed yes.

Mr. Lamont: It can never be in the interests of the company, or it is not likely to be in the interests of the company, to pay tax if they do not have to, unless all the shareholders agree.

Senator Everett: You suggest in your brief that estate taxes be reduced by the amount of capital gain that would be realized at death.

Mr. Lamont: Yes.

Senator Everett: I gather this would be a forced realization.

Mr. Lamont: Yes.

Senator Everett: Do you have any idea how that would operate?

Mr. Lamont: We think it would have to result in just a straight lowering of the potential amount of capital gains tax. In other words it would result in a lowering of the estate tax whether or not there was a capital gain element on death, because this is the only way you can be equal. The advantage of having it deemed to be realized at death and then reducing the total estate tax liability is that it makes it completely neutral as between a person realizing his capital gains during his lifetime or upon death; it becomes a far more neutral type of tax, particularly when the actual amount is one that they probably could accept.

Senator Everett: In that case, would the payment of capital gains tax be, in effect, a payment of estate tax?

Mr. Lamont: It would in effect be a portion that would, if you had capital gains, be effectively estate tax at the moment.

Senator Everett: So that in your proposal you would have lower estate tax and there would be a deemed realization at death.

Mr. Lamont: That is correct.

Senator Everett: And the amount of capital gains tax paid would be a credit against this estate tax?

Mr. Lamont: No. It would be a reduction of the value of the estate. In other words, you would not be paying estate tax on capital gains tax liability, which I believe is proposed at present. In other words you do not pay tax on tax, and it does not matter whether you liquidate and pay tax and then die, or die and then liquidate to pay the tax. There are some very serious arbitrary consequences, as I understand the proposals of the effect in this area.

Senator Everett: I believe especially if there is a forced liquidation.

Mr. Lamont: Yes.

Senator Everett: To pay estate taxes.

Mr. Lamont: If you can delay it for ever you do not have to pay it.

The Chairman: That appears in paragraph 7 of the White Paper.

Mr. Lamont: It seems to me it is very unfair if different taxpayers are to be treated in arbitrary and different ways.

The Chairman: I mean you might postpone paying your tax.

Mr. Lamont: If they reduced it to a reasonable amount people would not mind paying it. One of the points about the method we are suggesting it is that if you liquidate during your lifetime and pay your tax you would have reduced your estate by the amount of the tax.

Senator Benidickson: You would have paid it.

Mr. Lamont: You would have paid it, and if you do not liquidate exactly the same effect would happen upon death.

Senator Benidickson: What you say is simply that you take your capital gains tax, which has never been paid during the lifetime but becomes payable on death, and take that off the gross value of the estate and then assess an estate tax after that.

Mr. Richardson: That is correct.

Senator Everett: On page 64 of your brief under the heading "Goodwill", Item 10(4), could you explain subparagraphs (b) and (c) to me, please.

Mr. Ellis: Our concept is that in the goodwill in excess of original cost it should be taxed on the capital gains that might accrue and that this should be subject to a capital gains tax. Otherwise, if there was any resale or any sale of capital gains or goodwill earnings there would be a recapture similar to depreciable assets, but only the ability to write off if it in fact was a cash cost to the owner of the goodwill.

Senator Everett: Let us start at valuation day. What happens in your system to the difference between the market value of the underlying assets and the goodwill value that is attached to the shares?

Mr. Ellis: A tax would only be levied if, subsequent to the introduction, the amount of that goodwill to be established has increased.

Senator Everett: So that on valuation day whatever the value of the shares . . .

Mr. Ellis: It would not be subject to the tax.

Senator Everett: . . . on an earnings basis, if it exceeded the market value of the underlying assets, they would not be subject to tax.

Mr. Ellis: That is correct, and you would not be able to write that off.

Mr. Lamont: Only goodwill which was acquired for cash would be depreciable.

Senator Everett: What would happen on a sale in excess of the value of the goodwill on valuation day?

Mr. Ellis: That would be subject to capital gains tax.

Senator Everett: The difference between those two figures would be depreciable in the hands of the purchaser.

Mr. Lamont: The cash cost would be depreciable in the hands of the buyer.

Senator Everett: There is some indication in the White Paper that only assets are available for the goodwill write-off and that shares are not. Do you have any views on that?

Mr. Lamont: Goodwill is in a sort of technical area. There are a lot of major problems in principle. We do not have a strong view on the area of goodwill. Our own view would be that they would not be available for write-off on shares.

Senator Everett: Just on assets?

Mr. Lamont: Yes.

The Chairman: Senator Everett, are you relating goodwill to the value of shares or to the realization of shares?

Senator Everett: Yes, I expect I am.

The Chairman: That is the concept of goodwill.

Senator Everett: So far as I know the White Paper does not deal with shares in reference to goodwill, but there is some indication in the valuing of shares at valuation day. Where there is no market value the difference between the market value of the underlying assets and the price of the shares based on a multiple of earnings is a form of goodwill, and would be taxed retroactively.

The Chairman: I was thinking of the form and whether you can relate it to shares, because it is an intangible.

Senator Everett: Perhaps we could hear from Mr. Gilmour on this subject.

Mr. Arthur W. Gilmour, Senior Tax Adviser: Gentlemen, my understanding of the White Paper and all of the involved language is that the term "goodwill" has been defined over the years as being the value that is placed by a purchaser of a going business upon the prospects that the satisfied customers will keep coming to that place of business.

Goodwill essentially is the price that a purchaser will pay to a vendor who is selling him a going concern. In other words, somebody who is buying assets of a valuable going concern will pay an additional price because of the expectation of that profit. Therefore, your goodwill is akin to the price that you pay for the depreciable assets and the stock in trade. It is an intangible.

Under our present law goodwill is a non-depreciable asset. Akin to that there are, perhaps, prices that you might pay for an indefinite franchise to do business. These things have become known as the capital nothings, because you cannot write them off. Today, under our act there is great ingenuity displayed in the case of sale and purchase of assets of a business, whereby a purchaser makes quite certain that he is buying assets that he can depreciate or amortize. Of course, the vendor does his level best to ensure that he gets paid for the intangible on which he does not have to pay tax.

You often read court cases where the vendor of, say, a beer parlour puts the wholesale price on the franchise and, of course, claims that the fittings are all beat up, which they probably are, and literally worthless. The buyer says that those old beat up fixtures are platinum plated and that they are really valuable. This, of course, is a nice game of taxmanship that has been going on for years.

The White Paper proposes that when somebody buys goodwill as part of the purchase price of a going concern or buys an intangible franchise for an indefinite period that this will be regarded in the same way as though he had purchased depreciables. In other words, you have a capital cost based on the price you paid and you will be able to amortize that capital cost on a diminishing capital cost allowance basis just as applies to depreciables. Of course, the converse is that the vendor who sells his goodwill for a price will be deemed to have received proceeds of disposition of a depreciable asset. After a transitional period he will have to throw those dispositions, receipts on his part, into his income and he will have a deduction, namely the price he paid for his goodwill originally. Of course, you do not often pay for goodwill except when you are buying a going concern. Consequently, there is inherent goodwill naturally in every successful corporation. It does not appear on the value of the accounts, and in so far as I know in the White Paper there is no proposal that this intangible existing goodwill that is not required will be valued. In other words, it will carry on. So, we are just carrying on with a new class of depreciable asset, and when the White Paper says that this would be an impossibility without capital gains, I think it is a complete misstatement of fact.

The Chairman: Do they not say that capital gains would be impossible without including this item of good will?

Mr. Gilmour: I am not sure which was the horse and which was the cart.

The Chairman: Do you know if there has been any pressure or demand for this change, or is this a generous gesture on the part of the drafters of the White Paper.

Mr. Gilmour: I believe, Mr. Chairman, that for a long time, most businessmen have felt that the distinction between a depreciable capital asset and goodwill, which is a capital asset and which is a real thing which you buy, has been a meaningless distinction and has caused an awful lot of hardship. As you know better than I, there have been many cases dealing with capital amounts whereby companies pay good dollars for a very real and tangible asset, but they are denied any deduction, so there has been a pressure to treat the intangibles in the same way that the depreciables are treated. I do not think this is a concession; I think this is just plain common sense.

Senator Phillips (Rigaud): I think that Dr. Kenneth Eaton, if you remember, Mr. Gilmour, took a very strong stand on it, even when he was in the Finance Department.

Mr. Gilmour: Yes.

Senator Isnor: How do you deal with registered trade marks as an asset in goodwill?

Mr. Gilmour: If your registered trade mark, under today's law, has a limited life, and many of them do, your typical . . .

Senator Isnor: Suppose it is registered for 25 years?

Mr. Gilmour: Where there is a limited life—25 years or 17 years, or whatever the life is—and you pay money to purchase such a trade name or trade mark, then you can amortize the cost of the trade name or trade mark, or the patent, in equal annual instalments over the life of the particular item.

If you just create your own trade names, as is often the case, then the costs of creating this, by skillful advertising or by having a good product, are an expense each year, and there is no capital. So, you get a deduction there.

Senator Isnor: You get a deduction, do you say?

Mr. Gilmour: Each year, as with your advertising. You create your own trade name.

Senator Isnor: Yes.

Mr. Gilmour: If you go out to another company and purchase the right to use that trade name for a limited period of time, then you can amortize that purchase price over the remaining life of the trade name, and claim the annual amount as a deduction from your income.

The Chairman: Mr. Gilmour, you will remember that Senator Everett has to leave at 10.30.

Mr. Gilmour: Senator Everett, if I may just continue. The goodwill, as I say, is an asset which you purchase. When you come to valuing the shares of a company on V-day, or any other day, for that matter, ordinarily you do not consider the appreciation in a share in an amount beyond the book value of the share, or perhaps its realizable value or its sales value. That appreciation is not ordinarily considered as goodwill, and really has no application to the purchase of a goodwill item. That is the basic distinction, but I have taken a long time to try and explain it. So, as I say, I think our White Paper proposals deal solely with the purchase price you pay for goodwill when you buy it from somebody else.

Senator Everett: Thank you, Mr. Gilmour. Dealing with this situation, do you propose that the goodwill which exists in a company on valuation date would be depreciable?

Mr. Lamont: No.

Mr. Ellis: I think our concept at that time was that if there was a cost involved on the goodwill, it would be permitted.

The Chairman: If the price were split up as between the tangibles and intangibles, and was allocated to the intangibles, that would be a cost that you are talking about?

Mr. Ellis: Something that the company paid to acquire. An intangible . . .

Senator Everett: You propose in your brief, in the case of public corporations, that an option be given to values for capital gains purposes, either the higher of the acquisition cost or market, and for capital losses, the lower, I think of acquisition cost or market.

Mr. Lamont: Yes.

Senator Everett: Can you tell me how you propose to value the shares of privately held companies?

Mr. Lamont: I think the privately held companies will have to have some means of appraising the value of their company. I am sure we could set up a division which would go around and value the private companies, if necessary.

The Chairman: You have that problem now in the United States.

Mr. Lamont: There is a continuing process of evaluation where estate duties are going on. It involves a great deal of work. People might invent some formula which would provide a basis for it, that they could have it either evaluated now or, let us say, average the increase in value from the original acquisition period until the actual disposition, whichever they prefer, if that were a way of simplifying the problem. But I think if anyone had a built-in increment in value now, he would probably want to get an outside valuation from a trust company.

Senator Everett: You are suggesting a different form of valuation from that employed in the White Paper.

Mr. Lamont: They just say that you can pick your own because whatever you do they are going to get it back from you either by not giving you creditable tax or by taxing you when you die. I think you have to have a realistic evaluation of what the thing is worth at the time the capital gains tax is introduced.

Senator Everett: Do you agree that there is a retroactive feature to the implied valuation procedure?

Mr. Lamont: This is a technical area which we did not explore very far, but I think there are two aspects

to it. One is the immediate retroactive effect on the valuation of goodwill, because they assume someone is going to pay more for it because it is depreciable, which is not really necessarily a sound assumption. Certainly, a public company buying goodwill, has to consider that if they can depreciate it, it is also going to reduce their earnings. That is one area.

The other area, of course, is the question of the amount of creditable tax. The persons who get it, if they claim this higher valuation, are going to reduce the flow of creditable tax. So it comes in two ways; one complicated and one simple, but both retroactive.

Senator Everett: In your discussion on the transition period, I am not sure whether I understood your suggestion that there be no transition period, related only to capital gains and your proposal that there be a 15 per cent capital gains tax.

Mr. Lamont: Under the proposals of the White Paper, the concept of taking the transition period with respect to personal tax rates would cause very considerable problems—that is, phasing the reduction in rates over five years; because, in relation to the capital gains proposal, this would mean in Manitoba a taxation of capital gains realized during that period of about 90 per cent.

Senator Everett: You made that point very well, and I gather your suggestion is that the Government should go to the 15 per cent tax.

Mr. Lamont: If they are going to go to 50 per cent, then they should go to 50 per cent.

Senator Benidickson: Why not do it right away?

Mr. Lamont: Exactly. It does not cost them any money.

Senator Everett: Would you suggest that they go right to the 15 per cent tax?

Mr. Lamont: We are dealing with two sides. We are saying that if you introduce their proposal on capital gains then it is essential that you reduce the upper-lower level of personal income tax immediately, which we think is desirable anyway.

Senator Benidickson: Instead of forcing them to hold until it is 50 per cent.

Mr. Lamont: Yes; on the other hand, if you go to the capital gains proposal at a reasonable and acceptable rate you could live with the other rate, although it is not desirable.

Senator Everett: That is under the income section.

Mr. Lamont: Yes.

Senator Everett: So your idea would be to go immediately to the 15 per cent capital gains tax and have a transitional period.

Mr. Lamont: It would be immediate on the income, but it would not be so serious. The thing that makes it serious is the proposed treatment of capital gains for both widely-held and closely-held corporations, because it is 45 per cent or 46 per cent in Manitoba on even widely-held shares.

Senator Everett: You have a suggestion that the corporate tax rate be lower than the personal tax rate so that taxpayers are not induced to operate their businesses by way of partnership. Did you have any thought as to what the differential should be or what the corporate tax rate should be?

Mr. Lamont: Well, on the corporate rate what we really feel is that you cannot assume we are going to have 50 per cent forever. That is a very unrealistic assumption.

Senator Benidickson: Largely because of the threat of provinces raising their taxes.

Mr. Lamont: Or the international effect may be that it is just not competitive.

Senator Benidickson: I see.

Mr. Lamont: But I would think that if we are talking about a 15 per cent corporate distribution rate, the effect of that is 7½ per cent on income of the corporation so that if you had a 50 per cent rate you would end up with a 57½ per cent figure which would make that neutral as between personal and corporate tax on alternate distribution.

Senator Everett: Thank you. Mr. Chairman, I should like to thank Senator Phillips (Rigaud) for his suggestions.

Senator Molson: Mr. Chairman, may I say that the presentation of James Richardson and Sons Limited has been most impressive. The various members have given us a very clear exposition of their points of view. I should now like to ask what the collective view of these gentlemen is of the task that is facing the ordinary taxpayer in making a return under the proposals of the White Paper. Does it strike them that it will be considerably more complicated or will it be very simple for the ordinary Canadian taxpayer?

Mr. Lamont: As soon as you start getting into any income from corporate sources you are going to be in very great difficulty. It seems to be implicit in the proposals of the White Paper that you will take provincial credit against provincial corporate tax paid and federal credit against federal corporate tax, and at that the mind boggles, if that is what they actually do have in mind.

Senator Benidickson: And then there is the further complication that, although you may get a dividend, you do not get your credit if the company itself has not made a profit.

Mr. Lamont: It is just too complex for words, in my opinion.

Senator Molson: You think it will be very much more involved for the ordinary taxpayer to deal with.

Mr. Richardson: Very definitely, yes.

Mr. Lamont: It may be simple if you just have earned income; if you do not have Canada Savings Bonds or any kind of other assets, but just have earned income it may be simpler, but I doubt it. Once you get beyond being deducted at source it is going to be very complex.

Senator Molson: Now, Mr. Chairman, I should like to know what the view of these gentlemen would be on a matter we have discussed with most of our witnesses, namely, defining a small business and then continuing the present form of incentive of the low rate on the first $35,000 of profit and not having that provision apply to large companies, companies which were not defined as small companies.

Mr. Richardson: We feel very strongly that the low rate for small businesses should be continued. The definition of a small business is a problem, but not an insurmountable one. We very definitely believe it should be continued.

The Chairman: It has been suggested to us that a small business be defined in relation to the net profit. How would that appeal to you?

Mr. Lamont: That really is the suggestion we make. We would suggest a figure between $75,000 and $100,000 a year and then have a notch provision to take it up by steps to the full rate.

Senator Molson: There would have to be a notch provision.

Mr. Lamont: That is right.

Senator Molson: But you would favour that suggestion for consideration?

Mr. Richardson: Very definitely. Very strongly.

Mr. Lamont: There might be some merit in having a two-stage step-up to that level.

Mr. Ellis: Our concepts are compatible with that philosophy.

Senator Phillips (Rigaud): Mr. Chairman, I should like to put three questions. The first deals with the subject matter of integration, which I think Mr. Lamont dealt with, giving a clear indication on the part of your company that you are against the hard core, shall we say, of the White Paper involving this complex proposed method. In consideration of the present tax set-up we have had varying views with respect to the dividend tax credit, as to whether the amount should be retained at 20 per cent or whether it should be reduced downward or increased upward. May I have your views on this latter point?

Mr. Lamont: Well, the rate, which would be approximately the same as the 15 per cent corporate rate, would be about 35 per cent. It would be between 33 per cent and 35 per cent. That would certainly be an acceptable change and one which we think worthwhile as an incentive for Canadians to invest in Canadian enterprise. Certainly, I don't think it should be reduced.

Senator Phillips (Rigaud): Do you believe that the present system of corporate rate on the one hand and the dividend tax credit on the other hand has worked out reasonably well for the taxpayers of this country?

Mr. Lamont: I think it has, yes.

Senator Phillips (Rigaud): To the extent that you can get anything that is fair, you consider that as being substantially fair across the board for all sections of the economy?

Mr. Lamont: Oh, yes. It is particularly valuable because the shareholder who is really an investor in a sense is a partner in the enterprise, but it does not get him involved in the complex problems of the corporation.

Senator Phillips (Rigaud): Yes. That is the first question.

Mr. Hughes: It is not only fair, but it is to the advantage of Canada economically.

Senator Phillips (Rigaud): That is what I meant when I suggested that it would be fair, broadly, to all segments of our economy. In other words, you would bend with a system that is reasonably efficient in practice and one that is broadly equitable. That is my point.

The Chairman: Then, Senator Phillips, on that point, it gets rid of what looks like a distortion in the White Paper, where they seem to regard the income which a corporation earns as being partly corporate income and partly shareholder income.

Senator Phillips (Rigaud): Exactly.

The Chairman: Here you put it in proper perspective, and you say with regard to corporate income that they earn so much and they pay so much in taxes. As, when and if they pay a dividend, then the shareholder has income on which he pays tax and he will get certain credits.

Senator Phillips (Rigaud): And even more important, Mr. Chairman, he retains the same. The fundamental distinction is between the needs of the corporation and the desire of the shareholders for income.

Mr. Ellis: It discriminates between particular shareholders.

Senator Phillips (Rigaud): Yes, dividend policies which are based upon proper corporate administration leading to resultant tax flows whether to the individual or to the national exchequer.

Mr. Lamont: But if there were a substantial response by corporations to flow-out dividend income, and the shareholders were then expected to reinvest that, there is a very substantial cost in reinvesting once you make a distribution of that kind. A Corporation reinvesting funds is a book entry.

Senator Phillips (Rigaud): To say nothing of the frailty of the recipient shareholder who might want to use the money for other purposes than reinvestment. And with the inflationary circumstances, it could result in loss of savings.

Mr. Lamont: Well, this is one of the areas of the White Paper which favours dissipation rather than growth.

Senator Phillips (Rigaud): The next question I would like to put to Mr. Hughes concerns the subject matter of natural resource companies. We have had the advantage here of listening with great interest to a number of very important companies in the country who are engaged in the natural resource industries, prospective and otherwise, and in the process there seems to be a feeling, certainly in the minds of some senators, that we would be justified in drawing a differentiation, say, between steel companies, such as the Steel Company of Canada or Dofasco and Algoma who extract low-grade ore for the steel-making process as distinguished from other extracting mining companies, and also as distinguished from oil companies, and also as distinguished from bonanza companies who may go too quickly in terms of return of capital which would include funded debt, and as distinct from daring companies that open up our hinterland in the north and so forth. Could we get an expression of opinion from you with respect to the very important problem in dealing with resource companies as to whether distinction should be made in respect of tax incentives whether by way of tax holidays, depletion, applicable in varying ways and prompted by varying philosophies to the different categories.

Mr. Hughes: Senator, perhaps you have answered the question yourself, in your exposition of it. We have only focused, as you realize, sir, at the beginning on putting everything into one bag. There are very separate and distinct situations between extracting hydro-carbons and extracting minerals, and then you come to the other statement that obviously there is a great deal of variation, and we did not try to attempt to work out some sort of a system that would give benefits to all the people. As you will notice there, we deliberately avoided trying to come up with any concept, because we felt that the people in the industry knew much more about that sort of thing and the results of than we did. All we were trying to bring about was the fact that you must have incentives of this kind and to try to wipe them out in the way that it has been done—we did not think it would lead to the economic good of Canada. They talk about an industry that is there now and say, "We can tax it and change the rules for it", but that thing would never have existed had it not been for those incentives. So we did not focus this beyond broad solutions as to the variations within a single industry.

Senator Phillips (Rigaud): I certainly would not want to embarrass you or your colleagues on the question of which industries should have differentiation or which industries should receive greater or lesser incentive privileges. Obviously that would be an unfair question and embarrassing to you. But I would like to get an expression of opinion as to whether you think this Senate Committee should approach the subject matter of policy differentiation in categories, or whether there is merit to such study

and whether the financial underwriting houses which you represent in a very important way, and I am particularly thinking of Richardson, would consider that we were getting ourselves down into a bog and not get very far with coming up with something constructive.

Mr. Hughes: I suspect, senator, and I am speaking personally now, that you would be getting yourselves into a bog. Now there is one other thing here that I should like to mention. You said, senator, that perhaps we should treat something differently where somebody got a bonanza. By that you mean a high-grade ore body.

Senator Phillips (Rigaud): Yes.

Senator Benidickson: Perhaps where they had got their capital back in the holiday period.

Mr. Hughes: I think you have to look at this in the form of averaging it across the whole spectrum of mining and exploration. If I am spending money on exploration, and I happen to get a bonanza some place and I happen to get a very marginal one somewhere else, who is going to sit in judgement and say, "You should get this rate on this one, and another rate on the other one." I think the whole question is one of risk, and not in the overall what you might come up with

The Chairman: I think you have to go back a little bit further. You start off with the thesis the White Paper has where they say first of all that incentives are necessary. We don't have to argue that point. They say that we need that because of the risky nature and the areas in which these developments are good for the country. So you start off with that as an incentive, but the White Paper says that the incentives give too much, and that there are profitable operations in mining and it is a question whether these companies are bearing their fair share of the tax burden. How do you measure that?

Mr. Hughes: Senator, I do not think you can. What I was trying to say was, if you believe that certain incentives are necessary to bring something about, then it is unwise and unfair to go back afterwards and say, "In your case, that incentive was too much for you; we don't want to give you that much."

The Chairman: I was thinking, for instance, of Bethlehem Copper who appeared before us. Their evidence is a matter of public knowledge. There was a property in British Columbia which was nibbled away at for about 90 years by a succession of people, and some of these people came in and had some faith, but they could not raise any money because it was marginal. Then the Japanese came in and provided the money. But apparently when they opened it up, it proved to be better than expected and they paid back all the money used to bring it into production within eight years. They now have another 11 years of life in that operation. They are earning good money and enjoying depletion with a minimum of exploration expense. Could you say in terms in relation to that kind of a situation—and not necessarily naming Bethlehem Copper—that it could be said that when that situation develops, there should be a time limit on the length of time in which to enjoy the depletion? You can always bring it in again by exploring and developing.

Mr. Hughes: Senator, let us use that company as an example. We happen to be the fiscal agents for the company and we know what they are doing. They have spent a considerable amount of money on exploration in the last few years, and they are now embarked on a program where they will spend a lot of money on exploration.

The Chairman: That is the Cominco development?

Mr. Hughes: This is apart from the Valley Copper. They have now come up with that part of Valley Copper which involves exploration money. So, let us suppose that we made an arbitrary decision as to what they could do or could not do and, perhaps as a result of that arbitrary decision, they decided that they would not have gone ahead and explored for their part of Valley Copper, or the other explorations that they have going at the moment. I am trying to say that there is no way of sitting in judgement on these things. You must have a standard approach.

The Chairman: I am putting the proposition to you because I am looking for your opinions. I am not expressing necessarily personal views. I was wondering whether at a certain stage after you have had a tax holiday and paid back your debt, and have come into production with whatever money you raised and you continue along with an operation, is there a period of time when the allowance should cease, unless you earn depletion after that date? After you get back 200 per cent of what you laid out at that stage should the depletion that is received be an earned depletion?

Mr. Hughes: We have said in our brief that we believe there is some validity in what they are suggesting in relating depletion to the amount of money that is spent. We really do not know enough about it, and the intricate results that might take place.

Internally we discussed at one time the basis that is now suggested, one for three, and we suggested among ourselves that one for two may be a more appropriate figure. We hesitate to put that forward, because we just do not know enough as to how the internal decisions are arrived at.

The Chairman: We have heard the one for two suggestion, but there seems to be some unreality about that. In order to earn a dollar two dollars is spent. Why should you be spending one hundred per cent of your production income?

Mr. Lamont: I think you have to look at the mining industry in particular in relation to international competitive situations. The mining industry is not the same as other kinds of industries. There is some suggestion that in ordinary corporate enterprise in Canada, provided conditions are reasonable, some part of the corporate tax cost can be passed on to the consumers. There is no question that the cost of corporate income taxes are borne by the mining company, because it comes right off of their back. They have to deal entirely with world market prices. The corporate income tax is their cost.

When you relate that situation with the tax situations that mining companies have in other parts of the world you have to say that other countries seem to feel that it is necessary to provide a different treatment. For example, Ireland gives extensive tax-free holidays. Australia also has a substantially lower rate of tax on most mining. Your figures would probably be more accurate than ours, but it has been suggested that the effective rate of tax on most mining operations in Australia is around 35 per cent or equivalent to abour 15 percent depletion.

Senator Phillips (Rigaud): Sticking to the international scene, and we are all on common ground on the basis of required incentives, would you say that the present incentives are essential or necessary, having regard to the two fundamental factors, (a) on international tax concessions—that is to say concessions by international countries—and (b) the fact that the commodity produced is sold on world markets more or less like wheat. Before you answer me I will say that we are sensitive to a point of view that some people entertain in this country that although these concessions should be made, the country too far in.

Mr. Lamont: Mining is different from oil, because the depletion rate. . .

Senator Phillips (Rigaud): I am relating myself to mining.

Mr. Lamont: The depletion rate in the case of mining effectively lowers the rate of corporate tax. I do not think that you can introduce a special rate for corporate income tax for mines, so the depletion device is quite a useful one.

The other aspect of our incentives is the three-year tax holiday. From our point of view, in raising funds for bringing mines into production, the three-year tax holiday looks more important to us, because this affects the immediate cash flow of the company. If you limited the actual dollar amount of the three-year tax period you might still provide a sufficient incentive.

When you are going into a development of a mine there are so many uncertainties. You have the cost problem, recoveries and the prices you expect to get for your product three, four or five years ahead. This area, in terms of the three-year tax free period, we feel is important in terms of being able to provide cash flow. How it affects the actual incentive from a decision of a mining company to go ahead, we are not in a position to assist.

Senator Phillips (Rigaud): Most of the mining companies to whom we have put this question as to whether they would prefer retaining depletion and giving up the tax holiday, say to abandon the latter and retain depletion. That seemed to have been the common consensus across the board.

The Chairman: I recall something which was said here the other day, that if you do not have a tax holiday period and you, in that period, earn income you can always reduce the income to zero by writing off the pre-production expenses and your capital cost allowances. You do this at an early time. That was the intended purpose of the tax holiday. In application, of course, we know that pre-production expenses are postponed and even some capital cost allowances are deferred until after the tax holiday period has expired, which prolongs the non-taxable life of the mining property in production.

Mr. Lamont: Our approach deals with the financing and decisions which we view as being important, but which are not necessarily the ones which guide the mining companies. We are aware that the depletion is, in their opinion, more important than the tax holidays.

The Chairman: Would you say that the real question is what do you have to offer in order to finance your mining property? Everybody has agreed there must be incentive.

Mr. Lamont: That is a question which we probably could answer on financing of mining property. That is not the real question. The real question is the incentive which is necessary to keep on going and finding mining properties. The question as to any particular mining property, once it is found, is a question of feasibility studies and a margin of anticipated return in relation to the risk.

The Chairman: The incentives are very important factors as to whether you get the money or not.

Mr. Lamont: That is true, but the incentive is probably more important and more difficult to measure when deciding whether or not you will use Canada as the base where you will look for your mining properties. Finding that mining property is the great intangible.

Senator Phillips (Rigaud): A number of important mining companies have made the statement that the very publication of the White Paper has slowed down the ability to get capital in order to proceed with some of their programs. If the provisions of the White Paper were introduced the present large mining companies simply would not be economically viable on a competitive basis. Would you agree with those two statements?

Mr. Alexander: We have seen this with our offices on the continent. We have been contacted by different mining companies in areas in which we are looking. These companies which have been coming to Canada have told us that until the situation of the White Paper is cleared up they are keeping quite clear.

Senator Macnaughton: I think you should record the name of the witness who is speaking.

Senator Phillips (Rigaud): That is what I wish to know. You are definitely of the opinion that (a) development has been slowed down, and (b) if the White Paper provisions were implemented, having regard to the international character of the mining business, it would be questionable whether the companies in their present form would be viable on a competitive basis.

Mr. Alexander: Indeed.

Senator Phillips (Rigaud): I come now, Mr. Chairman, to my third question. First of all, I join with other senators in saying that I am under obligation to all you gentlemen cumulatively for a very important presentation which will be very helpful to us. I find it surprising that not sufficient emphasis has been placed upon the problem of the consent of the provinces to the implementation of the White Paper. I know you have dealt with it in your brief, but the White Paper itself makes the admission that the entire proposed system is conditional upon the consent of the provinces from the point of view of the distribution of tax—I do not like to use the vulgar expression "loot"—from the taxpayers. In view of the fact that it is pretty clear that the provinces are not likely to agree to the terms of this White Paper—and some have said so—and seeing the damage that appears to be being done now to the economy of the country, could I get your opinion on how this situation should be handled? We are proceeding to consider proposed legislation that is conditional upon the consent of the provinces, when we know that there is no likelihood of getting the consent of the provinces. I made the remark previously that we are living in a child's paradise sort of thing by discussing the White Paper and its proposed implementation when we know that the provinces are not going to agree. Could I get your reaction to that?

Mr. Lamont: There are two aspects to the provincial problems. One is the overall structure. I do not know whether they have concerned themselves with the detailed problems which you are experiencing every day or every week. We hope that they will realize that it has very practical problem. The other aspect is their share of the pie, which is of course hopelessly inadequte under these proposals.

Senator Phillips (Rigaud): You are kinder, you are using the word "pie"; I used the word "loot".

Mr. Lamont: In other conversation, I have described it as dividing up the corpse.

The Chairman: There would be only one division, if you are going to call it that.

Senator Phillips (Rigaud): Excuse me for interrupting.

Mr. Lamont: In terms of how one deals with the White Paper, your committee has been studying the matter for some four or five months, and you probably went through the same process as we did in reaching our conclusions in respect of it, and we are by no means the only organization which has been giving some thought to this. I do not think the Government could just back off and say this is not a good idea, without taking some account of the work that the public, senators, and the House of Commons has been involved with. People have got up in arms about it and they want to express their views and to have their views taken into account.

As soon as that process can be over, I think it is very desirable that some substantive statement of policy with respect to the proposals is in order. But until it is through, the economy and the committee and ourselves are going to have to live with it, because I think it is a very valuable process that is going on. I do not think it should be cut short. It is unfortunate that the proposals are so monstrous that they cause not only uncertainty and so much difficulty and in terms of proposals themselves being a problem.

Senator Benidickson: And politically a flak that continues indefinitely is quite a liability to the Government.

Mr. Lamont: Well, that is not our fault.

The Chairman: When you are looking at the proposals in the White Paper that you know, in order to be successful, must proceed on certain bases that are not even referred to in the White Paper, and you know that those bases are not possible of achievement, what do you do then?

M. Lamont: Just observing your proceedings in the last two days, I would think the committee had agreed that the corporation and shareholder approach is just not practicable, and if you remove that you solve 70 per cent of the problems. Then you can start looking at other individual problems on their own merits, but as long as that is staying there, you have got permutations and combinations on your hands. As soon as you pull that problem out . . .

Senator Benidickson: You mean, integration.

Mr. Lamont: Integration, and the gross-up of credit and the whole new structure which turns the tax structure upside down.

Senator Phillips (Rigaud): And rates of taxation which have no place in the White Paper. Integration and rates of taxes. If they were pulled out, then we could get down to the consideration of *ad hoc* problems—capital gains, small businesses, natural resource incentives, and so on.

Mr. Lamont: You cannot deal with the capital gains problems except in their context if you accept the corporation and shareholder concepts.

Senator Benidickson: These major items are all interwined.

Mr. Lamont: This is why we led off on that "core" proposal, which we think is fundamentally wrong.

The Chairman: Senator Macnaughton, I promised Senator Aseltine I would allow him to put his questions next.

Senator Macnaughton: I wonder if I could interject this, with the senator's consent, as it is really a subsidiary to Senator Phillips' questions.

Senator Phillips (Rigaud): I am through, Mr. Chairman.

Senator Macnaughton: At page 69, under the heading of "Conclusions", you say that the proposals do not recognize the needs of the provinces. Senator Phillips asked about the consent of the provinces. I know that in chapter 9, page 60, you developed certain points, but, for the purposes of putting it on the record, would you talk about the needs of the provinces and what you mean by that statement?

Mr. Lamont: Perhaps Mr. Lawson would like to deal with this, as he has been more intimately involved with the needs of the Province of Manitoba.

Mr. G. Lawson, Senior Vice-president, James Richardson & Sons Ltd.: We have thought from the outset that it was so unrealistic to try to set up a rigid tax structure that did not take into account the needs of the provinces, particularly at a time when they have been warned that they must be prepared to absorb a larger proportion of the cost sharing programs and that they must find their own taxes. Our concern is, where do the provinces find their own taxes under this rigid structure. Is it simply a surtax? If it is, the provinces that are in trouble are going to be in worse trouble.

Mr. Lamont: The surtax and the personal income tax destroys the foundation.

Senator Macnaughton: Tax on tax.

Senator Aseltine: Mr. Chairman, I notice in reading the introduction to this wonderful brief which we have had before us today, that the activities of certain of the Richardson companies include grain elevators and terminals, grain merchandising and related enterprises, real estate, real estate development, and it ends up by including farming. I gather from this, and from some other things that I have read in the brief, that the Richardson companies are vitally interested in the prosperity of western Canada.

I come from western Canada and I am very much interested in the growing of grain and other farming operations. I am interested in the value of farms, the

capital gains, and all that kind of thing. I wonder if any of you gentlemen have given consideration to the situation as it seems to be at the present time. A year or two ago, our farm lands were selling anywhere from $100 to $150 an acre. In view of the fact that the grain has piled up and there has been no sale for it, and that we have all this wheat acreage reduction programs and all that kind of thing, with practically no quotas for the sale of grain—and you people are interested in grain and marketing of grain—I find that the value of farm land has slumped and there is practically no sale at all for it. I know our office at Rosetown has advertised farm lands for sale for months, and they have not even got one offer.

What is going to happen? How are these lands going to be valued on valuation day? Have you given any thought to that? Who is going to value the land? Is it going to be my valuation as an owner or will it be appraised by some real estate firm or will we have to accept the Government valuation? I am interested in those things.

I am also interested in knowing what is going to happen after valuation day, if the values are very low. These conditions are not going to avail indefinitely. I am quite satisfied and optimistic that the prices of our land will go up again to where they were probably two or three years ago. Then, if I am a farmer and I want to retire and they take the difference between the value on valuation day and the valuation I sell my land at and they tax me 50 per cent on the capital gain, then when I retire I will not have anything to live on. I should like to know if you people have given those questions any consideration at all.

Mr. Richardson: Mr. Chairman, honourable senator, yes, we have considered many of the aspects that you have raised there. You are quite correct. We are very interested in the developing future success of the economy in western Canada. To answer your question about the valuation for farm lands, I believe we cover that on page 63 of our brief, where we say that due to the current depressed markets for grain, land values in western Canada have suffered a decline. That is perhaps an understatement. As this situation may prevail at the time values are established for capital gains purposes, we would recommend that the gains be taxed only from the cost or value on valuation day, whichever is higher.

Senator Aseltine: I read page 63, but I did not really agree with that. Perhaps, sir, we have not gone far enough there. These values have been substantially higher in the recent past and a lot of these costs will be very much lower than even existing values, because the farms have been in the hands of families for a long time.

Senator Benidickson: For a lifetime.

Senator Aseltine: I have land that I bought 40 years ago at $20 an acre.

Mr. Richardson: The real problem facing the farmer in western Canada is a combination of the White Paper and the Succession Duty Act. It is that combination of the two which makes the very bleak outlook for a family farmer in Canada today.

Senator Aseltine: This is the point I have arrived at: in view of the circumstances that prevail at the present time and which are likely to prevail for the next few years, farm lands that are producing grain and other agricultural products and that are not being held for speculation the principal reason the capital gains tax is being introduced, I take it—should be exempted from capital gains tax entirely. Have you considered anything like that? Would that not be the proper method under the circumstances?

Mr. Lamont: Mr. Chairman, we did not consider that specific item, but one of the problems with that kind of approach is the kind of problem which has arisen in Great Britain, where there is a much lower rate on agricultural land, for estate tax purposes, provided certain conditions are met. The fact is that the price of the land goes up in order to be able to wash through large estates. The fact is that it may be reflected in an increased value of cost of acquiring farm land because of the advantageous treatment for capital gains purposes, although, of course, if you don't have a free treatment on estate tax that might not be the same problem.

Senator Benidickson: Yours is a national firm with its head office located in western Canada. To what extent do you think the average farmer in western Canada has realized or does realize the predicament facing him if and when the White Paper is implemented and when the heavier tax succession duty, which was imposed in October 1968, affects him in connection with the passing from a father to a son? To what extent do the farmers in western Canada understand what may happen or what has to face them eventually when the father dies?

Mr. Richardson: I am afraid it is not being appreciated to any great extent. It is appreciated only in areas where there may have been a death and the situation has become evident in the community; then there is some realization of what faces all of them. But it has not been appreciated to any great extent by the farmers in the west.

Senator Aseltine: What I read the provisions of the White Paper to mean in regard to bequests such as Senator Benidickson has just mentioned, is that there is some doubt whether they take the valuation of the land at valuation day, because it states that when the beneficiary sells the property then the capital gains tax comes on everything over and above what it cost the testator. Now, the cost to the testator might have been little. It might have been a homestead 50 years ago for which he paid $10 a acre, plus whatever it cost him to develop it and that sort of thing. But if that is the case, I think it is very serious indeed.

The Chairman: Senator, you and I have talked about that. My view is that what was intended in the White Paper, although it is not clearly stated, was that when they talk about the cost they are talking about the cost as established on valuation day.

Senator Aseltine: That would be the cost basis?

The Chairman: Yes.

Senator Benidickson: The real value on V day.

The Chairman: You can call it V-day, D-day or any other day.

Senator Aseltine: If that is not the case, it is certainly going to be a bad situation.

The Chairman: I think you can take it that the members of the committee fully realize the problem and that there would be contradictions in the White Paper if any different definition were attempted. The purpose of a valuation date is to establish an up-to-date cost.

Senator Aseltine: Well, let us leave that point for a moment and go back to the question of how we are going to value these farm lands on valuation day. What is the process going to be? How is it going to be accomplished? Have you given any thought to that?

Mr. Lamont: We have not given detailed thought to that particular problem, senator. It is a particularly difficult area of what is a massive problem. It is not the only area where there are going to be serious problems with valuation, but I should think you would have to get an outside opinion as to what a willing buyer and a willing seller would exchange that property for at that date. If the Government does not agree with you, then you can go to law about it.

The Chairman: You could always go out and get an offer.

Mr. Lamont: Sometimes even the stock market is pretty thin, but the market in farm land is very thin indeed.

Senator Phillips (Rigaud): The great difficulty, Mr. Chairman, as Senator Aseltine has pointed out, is that if you take the valuation day at times of depression—and, in order to avoid confusion, I would suggest for the moment forgetting the question of synthesizing the White Paper proposals with the estate tax succession duty aspect—you get a very serious situation in respect of a homestead that has been developed over a lifetime. Now, if you talk about retroactive legislation that is vicious, you have it here, particularly when you think in terms of the trials and tribulations involved in the opening up of new territory suffered by these Canadians who are symbolized by Senator Aseltine. I would think it would be very helpful if an organization such as yours which is associated by those in eastern Canada with the provinces of the west would give consideration to these questions perhaps in the form of a supplementary brief filed as an addendum at some time.

Mr. Lamont: Well, we would hope that one way would be to put a reasonable level of tax. The same problem applies, but not to the same degree as applies to a farmer, to a bondholder.

Senator Benidickson: Your 15 per cent instead of 50 per cent would to some extent help in the situation.

Senator Phillips (Rigaud): But the bondholder has not had the problem of opening up the hinterland and new territories, and all that sort of thing, and has not given up certain amenities and advantages that have been given up by the homesteader through a lifetime.

The Chairman: One way of doing this might be to average the going price over the previous five years, or something of that nature. That might take up the high points.

Senator Aseltine: But there is a difficulty there, Mr. Chairman. I might want the quarter section of land which is beside mine, and if I wanted it badly enough I will pay twice or three times what it is worth to get it. But that does not establish a price for the quarter section of land which is a mile away from me and which might be as good or even better land.

The Chairman: But remember that the valuation on D-Day is such that the higher you get the valuation, the less capital gains tax you will pay later on.

Senator Aseltine: But you will pay higher estate tax.

The Chairman: You are caught in the cross-fire.

Senator Phillips (Rigaud): It is the only inducement in favour of death in the White Paper because they say the problems go to the testator.

Mr. Richardson: We have been aware of this problem and have been discussing what we would do after our appearance here today, and we had concluded that if you reacted favourably to some of the suggestions we have made, we would arrange to circularize a broad list of our farmer friends in western Canada, and we will endeavour, in working with them, to come up with some concrete suggestions.

Senator Aseltine: I think that would be a good idea.

Mr. Richardson: We would submit a supplementary proposal.

Senator Benidickson: The farmers individually have not been able because of financial problems to come and talk to us.

The Chairman: In that way we might get collectively what could be considered as a consensus.

Mr. Richardson: We will try. We feel that at least you can help by acquainting him with the problems with which he will be confronted if these proposals go through.

Senator Macnaughton: Mr. Chairman, we have had very good representations this morning. There is, however, a point which I would like to get on the record. Under the heading "Conclusions" on page 69, the last sentence on the page begins:

> The decision to attempt social reform and a tax increase along with tax reform added to the magnitude of the problem, particularly in assessing the economic consequences of the proposals.

Now, chapter II gives a very detailed discussion of this, and I refer you to page 11, paragraph 2:17, where it says:

> In conclusion, we question the contention in the White Paper that the economic impact of the proposals would be minimal. It seems obvious they would have a substantial detrimental impact on private savings and investment in the Canadian economy. Since investment is the prime generator of economic growth it is clear that the Canadian economy would not achieve a growth rate as high as it would have under the existing taxation system. This we feel, is detrimental to the welfare and prosperity of every Canadian—whether he is a member of the lower, the middle, or the upper-income group. The best way to improve the well-being of all Canadians is through the generation of a high rate of economic growth. This will do far more to benefit the lower-income group than a small per capita tax decrease.

Now, that is pretty clear in what it says. I was wondering if you could expand a little more on this since we have the benefit of the witnesses here.

Mr. Lawson: I suppose if you think the government can be a better driving force in the economy by creaming off the savings, you will disagree with what we say. But we don't think they are. We think it requires the push of the private entrepreneur to make the best use of that capital.

Senator Macnaughton: I am not disagreeing, but I am trying to get your opinion.

The Chairman: No, Senator Macnaughton. You will recall when we had one witness before us, and I am thinking of Mr. Jackman from Toronto, he put the proposition very bluntly and that is that Canada needs and has a continuing need for capital. Either private industry has to supply it or the State has to supply it. Now what you are saying is that if they siphon off savings, they siphon off the available capital, and therefore the state which is doing the siphoning will have to provide the capital.

Mr. Lawson: And will they make more effective use of the capital than the entrepreneur who will do it for selfish gain?

The Chairman: Well, there is no evidence to date that the Government is a better operator in the commercial world than private capital.

Mr. Hughes: The point is, senator, will they even have the capital after a certain number of years? They will use that capital for other purposes and we will not have it at all. After all, the world is capital-short, and if you destroy capital, it will make life much more difficult for us.

Senator Macnaughton: I was wondering if there was any other implication in "The decision to attempt social reform by means of the White Paper . . ."

Senator Phillips (Rigaud): Before we get to that, if Senator Macnaughton will allow me, I would like to point out that we examined Mr. Bryce and the observation was made that $600 million that would be diverted at the end of five years. It was maintained by

Mr. Bryce that this was an insignificant sum in relation to the gross national product. I asked him whether $600 million by way of assets for a borrower in going to a bank to borrow would be quite a significant sum of money and would it not run into the billions rather than $600 million, and would it not ultimately be of value to the economy in terms of perhaps four or five billion dollars. I think in answer I was honoured by the observation that it was a good question.

Mr. Richardson: We would agree with you that it was a very good question. We would also agree with your question.

Senator Phillips (Rigaud): I was hoping that you would agree that it was a good question.

Mr. Richardson: We also agree with your conclusion.

Senator Macnaughton: Am I trying to read too much into the statement that, as I see it, it is a decision to attempt to bring about social reform by means of the White Paper?

Mr. N. J. Alexander, Vice-president, Manager Partner, Richardson Securities of Canada: I think in the whole philosophy you are going from one of economics and savings to one of consumers, and that philosophy is basically wrong to my mind.

Senator Phillips (Rigaud): Mr. Chairman, may I discuss a question with Mr. Lamont which is on the periphery. This is the time to discuss peripheries. This deals with the question of accrual or cash basis for lawyers, doctors and dentists. Have you in your experience found that lawyers, dentists and doctors deliberately do not press for payment, and that they really are interested in cash flow?

Mr. Lamont: I am on both sides of that equation. When I was billing, I always tried to get my bills out and paid as quickly as possible.

Senator Phillips (Rigaud): I join you, and I belong to that brotherhood.

Mr. Lamont: When I was billing I always tried to get my bills out as quickly as possible.

Senator Phillips (Rigaud): I join you, and I belong to that club also.

The Chairman: Senators, I think we have covered the points in the submission, but I want to say to you, Mr. Richardson and your panel, that if there is any point which you feel you would like to develop further, of if we have not emphasized adequately any particular point that you have brought forward, we want you to say so now and go ahead with the emphasis. We are interested in getting opinions on these points which are very serious ones.

Mr. Alexander: There is one area in which I do not feel the implications are realized by the senators. Mr. Hughes spoke in respect to the year end effect of the capital gains.

Mr. Hughes: During last year as you are most likely aware, there was a drop in the eight-month period of $5 billion in the listed Canadian securities. If we had this last year I do not know what the effect of the revenue would have been. In addition to the $5 billion we had a drop of $8 million by bonds held. If you had had those figures together you could easily see that we would have reduced $1 billion or $2 billion from the revenues of the governments. We would have created at the same time chaotic market conditions.

Senator Phillips (Rigaud): I thought we sort of handled that inferentially by attacking the integration system generally. If it was taken out of the heart of the White Paper at least the losses would only be applied against the capital gains by segregation.

Mr. Lamont: The capital gains proposals have to be taken out of the income stream entirely.

Senator Phillips (Rigaud): I, for one, did not press that point, although I appreciate the significance of what Mr. Hughes said to it. I felt that the conclusions of the committee were that the integration system was too complex.

One does not like to use the word "absurd", but other people seem to feel that it is all right. If the hard core were taken out your point would lose some of its impact in terms of the danger signals. We would only be applying the capital losses against realized capital gains.

Mr. Hughes: There would be a matter of rate in addition to that. In the Province of Manitoba, if I were in the higher rate, even offsetting capital gains losses . . .

Senator Phillips (Rigaud): Are you suggesting that even if we had a capital gains tax of 15, 20 or 25 per cent that we should not pursue the possible merits of an approach that capital losses are only to be deducted from capital gains? We would have to do the best we can.

The Chairman: Is not this a basic defect in the capital gains part of the proposals, that you are permitted to write off losses against any income that you may have. From the point of view of the Government itself there is a real risk at a time when they need the revenue the most. There may be very little revenue left because of the impact of very substantial capital losses.

Mr. Hughes: At the same time they could not go to the capital markets, because they would have been destroyed.

The Chairman: There is the other aspect of it. The revenue which they estimate that a capital gains tax would not reduce is something that you must look at with very grave doubts if you are exposing all taxable income to reduction by reason of capital losses. How can you make an estimate that has any reality as to what capital gains tax under the White Paper will or will not produce?

Mr. Lamont: There is great scope for reduction of income under the proposals.

Mr. Lawson: I realize that we are not supposed to be asking questions. Does it not frighten you to think that that concept could get into that paper? What kind of thought has been given to allow that to get into the paper?

The Chairman: Maybe the answer is that the thought that was applied was not applied in those directions. They just did not think and were looking at the rainbow in the sky.

Mr. Richardson: It has very serious implications, not only for the Government, but the capital markets of Canada. It could virtually destroy them in a year end situation if the markets were depressed and there was very heavy forced liquidation.

Senator Benidickson: Some of you were present yesterday afternoon, and heard the submissions of Gulf Canada. They made the specific point that we should not have the capital gains tax in excess of the American tax, which is 25 per cent. I notice that in your brief you specifically recommend that there be a 15 per cent capital gains tax. Would any member of the group care to comment on the dangers or otherwise of a capital gains tax that is in excess of the American capital gains tax, particularly in view of the fact that one of your divisions is in securities and the raising of capital and selling of securities.

Mr. Hughes: We did comment on the American tax rate. We understand, although we cannot back this up, that the real yield in the United States is about 16 or 17 per cent. Not all people are at the higher rates.

Fundamentally, I do not believe in a capital gains tax at all, because it does not raise enough income to amount to anything. It is going to be very detrimental to the economic future of Canada. We have to buy the idea, because we feel it is a political fact of life and therefore we are going to have it. We hope that Canada will adopt one that will have the least economic impact.

What actually happens in Canada is that people put money into ventures at the early stages and when they become a little more mature and more acceptable to other investors that type of person will sell out and put his money into something new.

After looking over the political shoulder and the economic shoulder we decided that the 15 per cent figure is the one to start with. Does that answer your question?

Senator Benidickson: Not really. I was saying that if we had a 50 per cent tax and the United States had a maximum of 25 per cent . . .

The Chairman: It is only 50 per cent on half of the gain.

Senator Benidickson: For one form of corporation only.

Mr. Richardson: If the capital gains tax were higher in Canada than in the United States it would be very serious for the Canadian economy, and would have very serious implications.

Senator Aseltine: Fifteen per cent would bring in more capital I would think.

Mr. Lamont: We thing it would raise more revenue for the Government and we feel that our guess is as good as theirs.

Mr. Richardson: It would do two things, bring in more capital and bring in more revenue for the Government, because there would be more trading once a speculative situation has developed. The speculator or the developer would move into a new area.

The Chairman: It would be more acceptable to the people who are interested, because they could live with it.

Mr. Lamont: We do not like the capital gains, but I think the people who drafted the brief came to the conclusion that it was really an essential complement to the rest of the tax structure. We do not want to pay it, but without some form of capital gains tax at a reasonable level of taxation there is a gap. This is probably the largest gap in the existing form. You do not have to develop the White Paper proposals in order to round out the structure.

Senator Macnaughton: No tax might bring in even more money by making the country very attractive.

Mr. Alexander: This would be similar to Japan, because they have no capital gains tax. The Japanese laugh at us. They cannot understand why we want a capital gains tax just at this time of our development.

Mr. Richardson: Mr. Hughes was expressing a personal opinion. Our brief does state that we believe a capital gains tax, in all circumstances, is desirable, for equity situations and to have equality and fairness in the tax system in Canada.

The Chairman: Honourable senators, we have had a very interesting morning and a very full discussion of a very thorough brief.

We have your opinions which have been of value. It may not appear that way to you, until we get to the stage of report. I can say that there has been a definite value in them and it may be that the line of questioning indicates some of our thinking. But you may have to wait a little while for that. We wish to thank you for your contribution.

Whereupon the committee adjourned.

APPENDIX "A"

Submission to the

STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

on the

GOVERNMENT OF CANADA

WHITE PAPER, PROPOSALS FOR TAX REFORM

by

JAMES RICHARDSON & SONS, LIMITED

Winnipeg, Canada
March, 1970

TABLE OF CONTENTS

* * *

INTRODUCTION

1:1 This brief has been prepared by James Richardson & Sons, Limited and associated companies.

1:2 Richardson Securities of Canada, the securities affiliate of James Richardson & Sons, Limited is one of the largest securities firms in Canada.

1:3 The areas of activity encompassed by other Richardson companies include grain elevators and terminals, grain merchandising and related enterprise, insurance brokerage and insurance, real estate and real estate development, specialized forms of contracting, and farming. These include both relatively large and small enterprises.

1:4 Within these enterprises there are personnel with experience which may be of assistance to the Parliamentary Committees in their study of the Government White Paper, Proposals for Tax Reform. In particular, we considered that Richardson Securities of Canada could help assess the proposals in their impact upon securities markets, public companies, the raising of funds for enterprise and on the economy generally.

1:5 The brief is not intended to promote the interests of any particular segment or economic group. We hope that it will assist you in your efforts to devise an appropriate tax structure for Canada.

1:6 We believe that Canada requires an income tax structure which is broadly based, which has realistic rates and which should, within the overall revenue picture, support the recognized needs of government. The tax structure should be flexible, should promote economic growth and permit rewards for initiative. It should create an atmosphere that encourages the savings necessary for the development of Canada, and without offending foreign capital, should encourage Canadian investment. It should not be incompatible with the tax structures of our major trading partners and competitors. Tax consequences should be relatively certain. The tax structure should avoid imposing major distortions to economic decisions.

* * *

1:7 The expressed aims of the White Paper include a fair distribution of the tax burden; steady economic growth, recognition of social needs; widespread understanding of and voluntary compliance with tax laws; and a system that can and will be used by the provinces as well as Canada.

1:8 The proposals recognize some significant problems in our tax structure but the solutions appear to violate some of the expressed purposes, and in other respects to rest upon premises which are unsound:

- The aim of "fair distribution" is offset by proposals which imply the gravest discrimination against certain classes of

activity and certain types of investment.

- They involve a broadening of the tax base with an increase of rates for the most dynamic but already heavily burdened element of taxpayers.
- They discriminate against growth and development in favour of consumption.
- They imply a treatment of foreign investors uncountenanced by any other country and inconsistent with present tax conventions and international tax practice.
- They involve unnecessarily the introduction of a complex new structure which would occasion serious distortions and uncertainty.
- They are certain to have extensive effects on many aspects of the economy. Adequate analysis has not been made to take these into account in drafting the proposals.
- They imply a direct tax increase and an increase in the rate of tax growth as the economy expands.
- The appreciation of the needs of provincial governments appears to us to be seriously inadequate.

1:9 In the succeeding sections the White Paper proposals are related to a general economic framework and then discussed as they affect certain specific areas, setting out the relevant proposals in summary form, followed by our comments. These include analysis based upon the objectives referred to above.

ECONOMIC IMPACT

2:1 The tax changes proposed in the White Paper would undoubtedly have a significant impact on the Canadian economy. The precise nature of this impact and the overall effect of the proposals, are very difficult to determine when a completely new tax structure is imposed on an economy. It is vital that this impact be assessed - both for the short-term and the long-term - before a new taxation system is implemented.

2:2 In the White Paper the economic implications of the proposals have not, in our opinion, been dealt with adequately and in some cases have been ignored altogether. Therefore, we feel that both the entire package of proposals and each individual proposal should be examined closely by the government as to their effects on the future growth and prosperity of Canada. Of particular importance is the impact of the proposals on private savings and investment in Canada. If the proposals are to operate to stimulate or at least not retard economic growth, their impact on these two vital areas of the economy must not be detrimental.

Private Savings and Capital Accumulation

2:3 The tax reform proposals would reduce private savings and capital accumulation by decreasing the volume of new savings that would be generated in the Canadian economy and by reducing capital accumulated from past savings.

2:4 The greatest impact on private savings would arise from the tax increase that is built into the proposals. This would shift resources from the private sector to the public sector of the economy, and reduce private savings. This impact would be particularly large because the increased revenue is to be extracted from the high-savings sectors of the economy - the middle-class taxpayers ($10,000 to $25,000 income group) and corporations.

2:5 In addition to the serious implications for private savings created by the built-in tax increase, we also feel that such an approach is inappropriate for a number of other reasons:

(a) By building a tax increase into the proposals, the Federal government is attempting to impose tax reform, social reform and a tax increase in one White Paper. The government gives no indication of what it intends to do with the additional tax revenue or the need for it. The Canadian people and Parliament should be allowed to debate any decision of this nature independently of tax reform.

(b) Although the size of the increase in tax revenues (on the basis of 1969 incomes) after the five-year transitional period is a matter of dispute, it obviously would be large. However, on the basis of 1975 incomes - assuming only a normal rate of economic growth - it would be far larger than any of the figures presented in the current debate and would be accentuated by inflation. The steeper progression of

personal income tax rates proposed in the White Paper increases the rate of growth of tax revenues because taxpayers move more quickly into higher tax brackets as incomes increase.

(c) The United States is decreasing personal and corporate taxes while Canada proposes to increase them. For an open economy such as ours - with regard to the movement of both goods and labour - this widening of the tax differential between the U.S. and Canada would be detrimental to the Canadian economy.

2:6 The proposals also place great emphasis on the taxation of capital and savings over and above the impact of the overall increase in tax revenues. This impact arises mainly from:

(a) The shift in the tax burden from the median to the middle-class taxpayers. The median income group will consume virtually all of the tax relief it receives while the middle-class group must reduce its savings to meet the additional tax demands placed upon it.

(b) The taxation of capital gains would reduce private savings and capital available for investment. The most notable impact of a capital gains tax is that it comes almost entirely from savings and not from consumption. This is the economic rationale for a lower rate of tax on capital gains.

(c) The removal of the low rate of tax on the first $35,000 of corporate income would also directly reduce private savings and capital accumulation. The increased tax revenue derived from this source does not come out of current consumption, but instead reduces corporate savings available for investment purposes. Although inequities exist under the present system of granting this rate to all corporations, the removal of this rate would reduce the rate of private capital accumulation in Canada.

(d) The proposals to increase the taxation of the extractive industries would also reduce corporate capital accumulation.

(e) The combination of high estate taxes and a capital gains tax would have an extremely detrimental effect on past accumulations of capital and would quickly eliminate many substantial pools of private capital which are being used to the advantage of the Canadian economy.

2:7 Because of the adverse impact of these proposals on savings and capital accumulation steps should be taken to remove much of the increased tax revenues from the new system, and to reduce the anti-savings bias in many of the proposals.

Investment

2:8 The proposals for the taxation of the extractive industries could reduce investment in this sector of the economy both by

reducing the internal generation of capital within these industries and by diverting to other countries investment that would have taken place in Canada. This sector of the economy is large and extremely important to the overall performance of the Canadian economy accounting for approximately 25% of merchandise exports. Any reduction of activity resulting from the proposals would have a significant impact on economic growth in Canada. In addition, investment in mining and oil is very important for regional development in Canada. We feel that the proposals should be examined carefully and modified where necessary in order to maintain a satisfactory investment climate in the extractive industries.

2:9 The proposal to tax capital gains of foreigners (except those on less than 25% shareholdings in widely-held Canadian corporations) could operate to reduce foreign direct investment in Canada - particularly in the natural-resource sector. This proposal is unnecessary and unworkable, and could only do harm to the Canadian economy.

2:10 In general, we question the inward-looking approach towards foreign and Canadian investment activities. A number of proposals would operate against foreign investment in Canada and against Canadian investment abroad. In the long-run, we feel that this approach is misguided and that many foreign investment activities on the part of Canadians, particularly the development of Canadian

based multi-national corporations, and many investment activities of foreigners in Canada are - and would continue to be - very beneficial to the Canadian economy. In fact, the future prosperity of Canada very much depends upon a continued free flow of capital.

2:11 Finally, we feel that there is a conflict between proposals that provide incentives for Canadians to invest in Canada and proposals which reduce the volume of private domestic savings or remove incentives for particular worthwhile types of investment. If Canadians are to maintain and increase their ownership of the resources of the country, they must be left with the means and incentives to invest in the most dynamic sectors of the economy. Many of the proposals in the White Paper would achieve the opposite result.

Inflation

2:12 Under any given fiscal policy stance, the proposals have some inflationary implications:

- In the short-term, the shifting of taxes from the median to the middle-class group would be mildly inflationary.
- More importantly, in the long-run, the overall emphasis on the taxation of savings and capital accumulation would serve to reduce private investment in the economy and, hence, have inflationary implications. In fact, the proposals have a definite anti-growth bias and operate to

favour consumption over saving. If the Canadian economy is to experience stable non-inflationary growth and a rising level of prosperity for all citizens, a continued high level of investment is required - both to provide new capital facilities for the rapidly expanding labour force and to increase productivity. Without this Canada is unlikely to experience a sustainable high rate of economic growth.

Capital Markets

2:13 The proposals intended to favour Canadian investment in Canadian equities would cause many distortions in our capital markets. In some cases these distortions more than off-set the incentives provided.

2:14 The flow-through and gross-up proposals would cause a shift in the rates of return (after tax) between Canadian and foreign equities and within the Canadian equity market itself. Canadian investors would prefer dividend-paying fully taxable Canadian corporations and would bid up the prices of these equities. The prices of non-dividend and/or non-taxable Canadian equities would fall relative to other equities, and would become attractive to foreigners (who would not be eligible for the proposed incentives and would not be taxable on capital gains if they held a less than 25% interest). As a result, control of the rapidly growing and more dynamic corporations could pass to foreigners

while Canadians shifted to the more conservative type of equities. This would be especially true in the case of natural resource companies which would not be paying full taxes because of incentives provided by the taxation system.

2:15 The discrimination proposed between closely-held and widely-held companies as to current income tax treatment, taxation of capital gains and re-valuation would discourage the flow of new issues by able entrepreneurs who could effectively use capital from the public.

2:16 The differential dividend and capital gains treatment accorded to foreign equities could cause a re-flow of funds into the Canadian equity market by mutual and pension funds and cause distortions in the market by substantially increasing the demand for the limited supply of investment grade shares of companies which pay dividends and are fully taxable. On the other hand, other risk capital may become locked in to the U.S. market because of the positive capital gains treatment and may not return to Canada to finance new undertakings.

* * *

2:17 In conclusion, we question the contention in the White Paper that the economic impact of the proposals would be minimal. It seems obvious they would have a substantial detrimental impact on private savings and investment in the Canadian economy. Since investment is the prime generator of economic growth it is clear

that the Canadian economy would not achieve a growth rate as high as it would have under the existing taxation system. This we feel, is detrimental to the welfare and prosperity of every Canadian - whether he is a member of the lower, the middle, or the upper-income group. The best way to improve the well-being of all Canadians is through the generation of a high rate of economic growth. This will do far more to benefit the lower-income group than a small per capita tax decrease.

* * *

III

PERSONAL INCOME TAX

White Paper Proposals

- Increase basic exemptions.
- Continue standard charitable/medical deductions.
- Limited deductions for child care expenses.
- General deduction up to $150 for employment expenses.
- Moving expenses on changing location of employment.
- Additional amounts included in income - capital gains, unemployment insurance benefits, scholarships, bursaries, research grants and adult training allowances.
- Considerable changes in tax rates.
- Averaging provision allowed.

Comment

3:1 An assessment of the White Paper proposals on individual rates requires an exploration of the problems in the present system. In short they are:

(a) That certain earners who should not pay tax are in fact paying it;

(b) That the rates of tax upon the middle class and high income groups are extremely high;

(c) It is possible to obtain substantial accretions of wealth without bearing tax of any kind.

3:2 An examination of our present rate structure and source of income tax paid indicates that the most heavily burdened sector is the middle class. In 1967 the 6.7% of taxpayers in the $10,000. to $25,000. income class produced 23% of the revenue from personal income tax. The pre-occupation of the White Paper with so-called loopholes through which more aggressive taxpayers are slipping is an indication of two kinds of inequities:

(a) Disparity of treatment of taxpayers with similar income;

(b) The disproportionate burden imposed upon this group which motivates activity to minimize this burden.

The proposals certainly intend to remove the first inequity, but they also intend to intensify the second inequity by increasing the rates upon this group.

3:3 A comparison of Canadian and U.S. tax presented in the Canadian Tax Journal is set out in Tables I and II. (i) Table I indicates that levels of tax in the United States are significantly higher than in Canada at the $4,000. a year level and comparable or slightly higher at the $6,000. level. Thereafter the amount of tax in Canada is substantially higher than in the United States until about the $50,000. bracket. This comparison has taken into account capital gains and its taxation or lack of it in the respective countries assuming that comparable individual income groups in Canada and the United States have comparable gains - an assumption

(i) *David B. Perry, "Fiscal Figures" (1970) 18 Canadian Tax Journal 54*

Table I

Comparison of Canadian and U.S. Individual Income Tax Based on 1969 Rates

Total Income Class	Average Total Income Including one-half of Capital Gains		Canada Combined Federal and Provincial Taxes Payable in: Ontario[1]	Manitoba[2]	U.S. Combined Federal and State Taxes Payable in: Nevada[3]	Vermont[4]
$	$					
2,000 to 4,999	3,900	Amt $	82	86	122	157
		% of Total Income	2.1	2.3	3.1	4.0
5,000 to 6,999	6,000	Amt $	488	514	416	529
		% of Total Income	8.0	8.5	6.8	8.7
7,000 to 9,999	8,500	Amt $	1,094	1,154	758	956
		% of Total Income	12.8	13.5	9.0	11.3
10,000 to 14,999	12,000	Amt $	1,962	2,082	1,412	1,781
		% of Total Income	16.3	17.3	11.8	14.8
15,000 to 19,999	17,000	Amt $	3,120	3,324	2,449	3,090
		% of Total Income	18.6	19.9	14.4	18.2
20,000 to 49,999	28,000	Amt $	7,224	7,728	5,386	6,794
		% of Total Income	25.6	27.4	19.2	24.2
50,000 to 99,999	66,000	Amt $	23,456	25,155	20,855	26,295
		% of Total Income	35.5	38.1	32.0	39.9
100,000 to 199,000	132,000	Amt $	50,164	53,871	54,487	68,707
		% of Total Income	38.0	40.8	41.4	52.2
200,000 and over	418,000	Amt $	160,535	172,464	227,776	287,255
		% of Total Income	38.4	41.3	54.5	68.7

[1] Provincial tax is 28% of federal Basic Tax.

[2] Provincial tax is 35.5% of federal Basic Tax.

[3] No state income tax.

[4] State income tax is 25% of federal tax before surtax, plus a 15% surcharge.

Table II

Comparison of Proposed Canadian and U.S. Individual Income Tax Assuming Tax Reform Proposals Fully Implemented

Total Income Class	Average Total Income Including one-half of Capital Gains		Canada Combined Federal and Provincial Taxes Payable in: Ontario[1]	Manitoba[2]	U.S. Combined Federal and State Taxes Payable in: Nevada[3]	Vermont[4]
$	$					
2,000 to 4,999	3,900	Amt $	nil	nil	15	19
		% of Total Income			0.4	0.5
5,000 to 6,999	6,000	Amt $	445	483	299	385
		% of Total Income	7.3	8.0	4.9	6.3
7,000 to 9,999	8,500	Amt $	1,100	1,195	580	746
		% of Total Income	12.9	14.0	6.9	8.8
10,000 to 14,999	12,000	Amt $	2,127	2,310	1,169	1,505
		% of Total Income	17.7	19.1	9.7	12.5
15,000 to 19,999	17,000	Amt $	3,460	3,757	2,095	2,697
		% of Total Income	20.7	22.5	12.3	15.9
20,000 to 49,999	28,000	Amt $	7,652	8,310	4,704	6,057
		% of Total Income	27.1	29.5	16.7	21.6
50,000 to 99,999	66,000	Amt $	23,738	25,778	19,008	24,473
		% of Total Income	35.9	39.0	28.8	37.1
100,000 to 199,999	132,000	Amt $	45,817	49,755	49,904	64,252
		% of Total Income	34.7	37.7	37.9	48.8
200,000 and over	418,000	Amt $	146,669	159,266	208,516	268,464
		% of Total Income	35.0	38.0	49.9	64.2

[1] Assuming provincial rate of 28% of federal tax.

[2] Assuming provincial rate of 39% of federal tax.

[3] Assuming no state tax.

[4] Assuming continuation of existing state tax of 25% of federal tax, plus a 15% surcharge.

which probably has validity at lower levels of income though the comparison at higher income levels is more suspect.

3:4 The pyramid of taxpayers in Canada is much flatter and lower than in the United States. In 1967 three-quarters of Canadian income taxpayers had incomes under $7,000. At the same time the level of services provided through the public sector in Canada is similar to that in the United States, and the rate of tax upon incomes on $7,000. and below in Canada is lower than in the United States.

3:5 The comparison presented in Table II which assumes that tax reform proposals have been fully implemented in Canada and the United States, indicates that the levels of tax in the United States are slightly higher at the $4,000. a year level, substantially lower to the $28,000. a year level, and slightly lower to the $66,000. a year level. Thereafter the Canadian tax is lower especially in the $200,000. a year and over level.

3:6 In terms of revenue contribution, tax at the highest rates in Canada is not very significant because there simply is not enough income subject to such rates. The lowering of the maximum personal tax rate to 50% is estimated to cost only $40 million. It is the income between $10,000. and $25,000. a year which presently carries a very heavy burden, not merely to assist the needy of our community, but to provide a significant subsidy to the average wage earner as well.

3:7 The White Paper proposes to extend the net of the tax gatherer as it affects this heavily taxed but productive segment of our society and to increase the rates of tax applied to a broadened definition of income. This is made necessary because:

(a) the government proposes a very small per capita tax reduction at the lower levels of taxable income which necessitates intensifying the progression upon the middle class.

(b) the government is proposing a tax increase.

3:8 It is important to realize that neither the exemption of the 750,000 taxpayers, as recommended in the proposals, nor the reduction of the maximum rates of tax are significant in themselves in revenue cost. The reduction of tax at the lower levels of income transfers a burden which is relatively light when spread over 6½ million taxpayers but which is now to be confined largely to taxpayers receiving over $10,000. a year (about 495,000 in 1967, of whom 447,000 were below $25,000. income).

3:9 We believe that an important priority in tax reform should be a reduction in the rate of progression of personal tax rates up to the 50% level. The lowering of the rate of tax on the highest levels of income is a desirable aspect of the proposals because the present rates are Draconian and indeed produce relatively little revenue. In our view the 50% maximum personal rate recommended in the White Paper should not be reached as low as $24,000.

3:10 The easing of the rate of progression would result in some loss of revenue. However, the White Paper proposes a substantial increase in tax revenue and it is possible that this increase need not be as great and should be reduced enough to permit an easing of the proposed personal tax rates on all levels of income instead of on the lower half and upper 1% of taxpayers, recognizing that the rates would be applied over a wider range of income.

3:11 One area where revenue might be made up is by eliminating the so-called employment expense allowance of 3% of employment income up to $150. There is a relatively narrow range of employees, usually skilled, who incur expenses other than personal ones which cannot be effectively imposed on the employer. Unless he can account for and deduct these actual expenses, he will still suffer the same relative injustice as at present since the deduction is available to all other employees to whom it represents an increase in exemption. This will be expensive in revenue since it affects all employed persons at their marginal tax rates. It is inequitable to give a benefit to all in order to provide a justifiable need for a few. It then ceases to be a benefit for the purpose intended. Defined employment expenses which are accounted for should be deductible, but a general allowance is wrong in principle.

3:12 A similar area is the standard deduction for charitable and medical expenses which operates as an increase in exemption for those who do not have these expenditures, discourages the smaller contri-

bution to organizations such as the United Way, and discriminates against those who do contribute. Virtually all charities are now registered, so that supervision should be feasible. The proposed substantial increase in personal exemption would allow these deductions to be put upon an actual basis, and this should be done.

3:13 With respect to medical expenses, however, the proposal is not generous enough. The 3% minimum was based on the assumption that the taxpayer should assume that portion as a normal part of his living expenses. In provinces where medicare is in force (and all provinces have hospitalization) the taxpayer is taking care of the normal portion of medical expenses through premiums and/or taxes. If the taxpayer is in a low income bracket, medical costs outside of insured services quickly become extraordinary and relief is a real necessity. For higher taxpayers, it might be recognized that their taxes are not only covering their own medical costs but contributing to others. An allowance of costs over the greater of, say $100., or a smaller percentage of income - 1% - 1½% - would be more appropriate.

3:14 The White Paper recognizes a problem with respect to abnormal concentrations of income in one year (likely to be more prevalent with taxation of capital gains) but there is a need for more liberal provision than that proposed. The need for such a provision is particularly important for the taxpayer who is in a lower tax bracket.

3:15 The White Paper also recognizes an important problem with respect to child care expenses. Here again we believe that the deduction permitted should be more extensive, particularly since any revenue loss would probably be more than made up by the production of taxable income. The tax structure should not necessarily encourage mothers to go out to work, but it should not penalize them either.

3:16 The changing of the rate structure is proposed to be immediate as far as all aspects other than the lowering of the maximum rate which is to be reduced to 50% over five years. This reduction is estimated to cost only $40 million in revenue and the reason for phasing is not explained. We agree that this maximum rate should be lowered substantially, but there are compelling reasons to establish the new upper rate coincident with the other changes.

3:17 Taxation of capital gains will be effective immediately and upon existing tax rates this would mean taxation in some provinces at 90% initially, not the 50% rate to be in effect after the transition (45% and 25% in the case of gains on shares of widely-held companies). Since one of the characteristics of a capital gain is that the timing of realization can be determined by the holder, there will be a minimum of realizations by the higher tax-payers during the period of transition. Obviously realization and payment of tax will be deferred. The economic and market effects of this distortion could be serious and unfortunate and the phasing of the reduction appears to be unimportant in potential revenue.

In addition, devices to defer income during the transitional period would spring up and the full recognition of capital losses would itself provide a powerful tool in reducing income, to be recovered at much lower rates of tax in later years. The scope for this under the proposals would be quite extensive.

3:18 The White Paper proposes to treat scholarships and bursaries as taxable income. It is apparent that the size of these awards are presently determined in part by the fact that their receipt is non-taxable. Existing charitable sources which supply these funds may have difficulty increasing awards to offset the impact of tax. Provincial governments are another major source of bursaries and scholarships. An increase in provincial bursaries to offset income tax would in effect transfer resources from the provinces to the federal government. This kind of receipt is normally not taxable in the United States or the United Kingdom and it would be anomalous if a bursary or scholarship to study in Canada would be penalized in comparison to the same award to a Canadian studying abroad.

3:19 In view of the foregoing the proposal should be abandoned as there does not appear to be any substantial abuse to be remedied.

IV

CAPITAL GAINS

White Paper Proposals

- Gains and losses on the disposition of all assets are to be brought into income.
- For widely-held "Canadian shares" half the gains and half the losses will be brought into income, but unrealized gains and losses are to be brought into income every five years.
- Limitation on taxation of gains on disposition of principal residence and articles of personal use.
- Gains and losses to be from "value" on some day to be fixed; concession for bonds if acquisition cost higher than base cost.
- Non-residents taxed upon capital gains from real property, partnership interests, branch assets, shares of closely-held companies, and holdings of more than 25% on shares of widely-held companies.
- Deemed realization upon giving up residence in Canada.
- Gains not realized on death, but cost basis retained except for estate tax paid on the asset.

Comment

4:1 The proposals recognize that gains from the disposal of capital assets are different in kind than income flows.

4:2 Many, but not all taxation systems recognize a distinction between gains and losses on capital and ordinary income flows and make provision for taxation of these upon a different basis than that of income. Some aspects which distinguish capital transactions

are their relative infrequency, size in relation to income flows, the optional nature of realization, and the fact that their realization is not usually directly related to consumption expenditures. Gains and losses affect the transfer and retention of savings within the community, but not normally consumption. The taxation of gains (which are created by a transfer of savings) will transfer resources from private investment to public consumption. In a progressive income tax structure both gains and losses could have extensive impact on the individual's current taxation position, particularly since realization of the gain or loss depends upon his own decision.

4:3 From the point of view of the holder, the taxation of gains represents a diminution of assets, to the extent that as long as he can retain his assets and not pay tax on a gain, he can enjoy an increased value of the asset. As soon as he liquidates, his ability to replace that asset is diminished to the extent of the tax liability. Holders tend therefore to defer this diminution, particularly if the asset is income producing. The incidence of the tax is therefore quite uneven as between holders of capital, depending upon their willingness or need to realize.

4:4 We accept the taxation of capital gains as necessary to complement other parts of the tax structure, but to be accepted as fair the basis of taxation of these gains should be a separate part of the income tax structure and at lower rates than the progressive rates on other income.

4:5 The proposal to in effect apply a preferential capital gains rate only to the shares of widely-held companies will have serious discriminatory effects with respect to other capital assets.

4:6 In the case of the bond market, it will make it a less attractive vehicle for investors and it fails to recognize the real capital risks in the holding of bonds.

4:7 In recent market conditions, companies raising capital from the public have found it necessary to rely upon convertible bonds or convertible debentures in order to provide an attractive security for investors. Different tax treatments for the bond or debenture as opposed to the shares into which the security is convertible would create serious anomalies in the secondary markets for such securities. A related problem would apply to share purchase warrants.

4:8 The discrimination proposed against investment in foreign securities is also unwise. It is, as far as we are aware, a degree of discrimination which is unprecedented and invites retaliation by foreign countries. Such retaliation would affect portfolio investment, which is certainly an acceptable and essential addition to our capital resources.

4:9 The discrimination would reduce mobility of Canadian investors. It would discourage the liquidation of substantial profits in the foreign markets, and deny the Canadian market a potential source of new capital when Canadian markets were buoyant. It is particularly under these conditions that funds for new investments are raised in

public markets. Deterring these Canadian savings from new investment in Canada, by reason of the tax structure, seems short-sighted.

4:10 The distinction between closely-held and widely-held companies as proposed in the White Paper is invalid. The taxation of gains in closely-held companies however, exempts retained earnings and proposes to tax the earning power created at full income rates, thus discriminating against growth.

Valuation Day

4:11 The adoption of valuation day as the cost basis for taxation of gains creates serious problems of equity.

4:12 The market does not measure value for large blocks of stock even in actively traded securities. In other cases the market is not broad enough to absorb substantial volumes of shares. The market is, in any event, a measure of value only for the willing buyers and sellers at that price and then only if their holdings could be sold at that price.

4:13 A reasonable approach respecting the taxation of gains on shares would be to tax only from acquisition cost or value on valuation day, whichever is higher, and to allow losses only from acquisition cost or value on valuation day, whichever is lower. We note that the United Kingdom capital gains tax accepted cost or value on the date of introduction, whichever was higher, in order to avoid retroactive taxation of gains or taxation of the

recovery of losses.

4:14 The proposal to tax gains on bonds at full rates has been mitigated somewhat by subsequent statements but ignores the very depressed market for bonds and ignores the fact that active investors in the bond market will have adjusted their portfolios in order to improve term and yield. These investors will have suffered current losses and will be entirely taxed on the recovery of these losses. Since there is a substantial capital risk in bonds, a capital gains tax treatment for these securities is appropriate.

4:15 It is worth noting that a number of major assets including securities generally, homes in certain areas of Canada and farm land in Western Canada are currently at depressed values. This fact will aggravate the impact of taxation of gains on these assets. The gains here again should be taxed at a capital gains rate lower than the progressive income rates.

Revaluation

4:16 It is difficult to understand how any scheme of tax reform which purports to place "fairness" as its first objective should single out one class of assets, i.e., the shares of widely-held companies, and require the holders to revalue every five years and pay tax on any unrealized gain.

4:17 The problems for the controlling shareholder are obvious. The public has a substantial interest in stability of control of corporate enterprise. As underwriters, Richardson Securities of

Canada is aware of the necessity of securing stability of control and stability of management for issues which are offered to the public. The securities commissions are also concerned with this aspect. Furthermore, shareholders whose holdings "may materially affect control" may only distribute their stock through an offering by prospectus filed and accepted by the relevant securities commissions.

4:18 The problem would be most acute for those companies in the natural resource industries or high growth areas where the market is valuing expectations and future earnings very highly. The market price of this type of security would not be reduced through the payment of cash or stock dividends because there would be no creditable tax to distribute.

4:19 The proposal to tax so-called gains without realization is grossly discriminatory relative to other assets. Particularly is this so for controlling shareholders who have gone to public markets, as opposed to "closely-held" situations, where the proposed income tax situation would be more favourable.

4:20 If it is accepted that controlling shareholders must necessarily be exempted from this arbitrary impost, it is difficult to see why the public investor should be singled out for revaluation. It is unsound to consider as income, gains which have not and may never materialize.

Effect of Losses

4:21 The proposals with respect to losses do not appear to have taken account of the potential impact of capital losses on government revenues or distortion to the capital market in the event of a sharp market decline. Even with the limitation of losses applicable in the United States, substantial market impact is felt through the realizations of losses during the latter part of the year. If half the losses could be set off against personal income this would cause, in our opinion, more serious distortion to the capital market during periods when the market was already depressed and a substantial reduction in personal tax receipts.

4:22 An examination of the variations of the Toronto Stock Exchange indices during the first eight months of 1969 illustrates the potential impact of the above:

	High	Low
Industrial	198.77 (May)	164.25 (July)
Gold	276.96 (March)	159.92 (August)
Base Metal	122.54 (May)	97.85 (July)
Western Oil	310.73 (June)	207.67 (July)

A rough calculation indicates that these swings would represent changes of about $4 billions in quoted market value of the industrial index. $100. millions in gold, $500. millions in base metal and $900. millions in oil, or market fluctuation over $5. billions over the course of 8 months. We are advised that transactions in the index stocks comprise about 70 - 80% of daily volume on the exchange.

4:23 The taxation of bonds and debentures at full income rates, and complete deduction of losses could occasion even more catastrophic effects upon government revenues during periods of declining markets. This is particularly so since the revision of portfolios could be accomplished with actual realization of securities and replacement with different bond issues of equivalent quality, yield, and maturity. In other words, holders would be able to bunch losses and spread out income.

4:24 The total value of federal, provincial, municipal, corporate and institutional obligations, is about $55. billion, excluding Treasury Bills and Canada Savings Bonds. While most of these holdings would be in institutional hands and many of the issues would, by reason of coupon rate or maturity, not be subject to great fluctuation, it is noteworthy that some of the Government of Canada issues declined as much as 14% during 1969. The effect of tax loss selling by individuals during periods of tight money could cause serious distortions, and could cause very substantial offsets against taxable income, even if the percentage of securities held by individuals was relatively small. The resulting pressure on the bond market could occasion support from the central bank which may be contrary to monetary policy.

4:25 The proposal for full taxation of capital gains and full deduction of capital losses with respect to foreign securities of which the bulk would be American, would also have serious revenue implications during periods of substantial market decline.

Rates

4:26 The comments outlined above indicate the reasons why we believe that capital gains cannot be treated the same as ordinary income. The question is what kind of taxation, if any, is suitable in order to achieve reasonable equity, achieve economic efficiency, protect the revenue, encourage investment and conserve saving.

4:27 The actual revenue from a tax on capital gains will not be great and we believe that the potential revenue losses if the White Paper proposals were adopted would be substantial. Since our present system exempts capital gains from tax, we can approach the actual rate to be applied with a relatively open mind.

4:28 Provided that a reasonable balance can be obtained between the other objectives, we believe that the rate to be applied should be one which would not distort economic decisions. The evidence of United States experience is that the maximum rate of 25% creates "lock-in". Indeed, the proposal to apply five year revaluation concedes that such an effect would exist and be substantial. The taxing of other capital gains at full income rates will be even more significant.

4:29 In our opinion a rate of about 15% would be the maximum that would be accepted without significant distortion.

4:30 We think that such a rate would minimize the disparity between those who realize gains and pay tax and those who do not and enjoy the increment through, for example, increased income flows. In our

opinion it provides reasonable equity with ordinary income for two reasons: first, that full (or half) offset of capital losses cannot be given against income because the revenue effect could be disastrous; secondly, the risking of capital differs in kind from regular income flows.

4:31 By their nature, gains on the disposition of assets arise by the transfer of savings. The conservation of savings is desirable and the mobility of capital which such a rate would permit would also contribute significantly to the advancement of our economy.

4:32 Paradoxically, we believe that a rate of 15% would, in fact, create more revenue than a higher rate, and although this would reduce savings, the increase in economic efficiency could in our opinion outweigh the direct loss of savings. The kind of effect which we foresee is the freeing of venture capital which would be available for investment in high-risk situations. If the venturer can liquidate his commitment at reasonable tax cost he can pass on ownership to investors who are necessarily more conservative. If the liquidations result in excessive tax cost, the venturer may retain his position and take dividend income. Since there is a limited supply of capital for this type of investment its immobility as a result of the tax environment would be particularly unfortunate.

4:33 Our decision on rate is necessarily a matter of judgment, but it is considered judgment. By introducing a relatively "neutral" rate of tax on capital gains we would have an opportunity to assess it over a period of time. In particular, it would give us an oppor-

tunity to compare our experience with other countries, for instance, the United States. If, as we suspect, the revenue was comparable with other taxation systems with higher rates, we could be satisfied that we were on the right track. Nothing could be more absurd than to have high rates of tax which produced less revenue than lower rates of tax. Since we are beginning, so to speak, at the beginning, it seems appropriate to introduce a lower rate with the option of increasing it, rather than vice versa.

4:34 In order to protect the revenue, we would suggest that losses be deductible from gains only (with full carry forward).

Estate Tax

4:35 The manner of impact of capital gains tax as it applies to an estate appears to be extremely arbitrary and may result in extraordinarily high rates of tax upon an estate. It is obviously unsatisfactory if the tax implications on realizations of gains in relation to the date of death create substantially different tax treatment. The imposition of a tax on capital gains requires substantial modification of the estate tax structure.

4:36 The proposals suggest that capital gains on assets need not be realized on death, and that their cost basis be adjusted by any estate tax paid on the unrealized capital gain. This is a contrast to the five year revaluation but in effect it proposes imposing estate tax upon the capital gains tax liability. The proposed

treatment appears to put a substantial premium on dying with one's gains, particularly on assets other than widely-held shares, rather than realizing and paying tax.

4:37 We would suggest that capital gains be deemed to be realized upon death, and tax deducted from the estate for calculation of estate tax. This would neutralize the timing of realization. At the same time, maximum estate rates should be reduced so that the total estate tax burden and capital gains tax would not exceed the present burden. This would result in a much fairer incidence of tax as between estates of the same size and remove one disincentive to realize upon capital gains. It would also remove a serious inequity as between estates which would have to realize to pay estate taxes or distribute property, and those which would not. Our recommendations in this area are interdependent, but in any event the imposition of tax upon capital gains necessarily require restructuring the estate and consequently the gift tax.

Gains on Homes

4:38 In the area of homes, taxation on any basis (except perhaps after all reasonable rollovers have been extended and exhausted) involves a serious injustice without even producing significant revenue. House markets in most of our major centres are subject to quite substantial fluctuations. Losses would not be deductible, while apparent gains would be needed to acquire another residence, the price of which is likely to have been affected by the same

factors which affected the price of the first sale. This is particularly true of transactions within the same urban area, and these are, of course, quite common. Provided the proceeds are reinvested in another home, the normal situation would not result in real gains to the homeowner.

Realization on giving up Canadian Residence

4:39 The proposal to deem realization of gains on departure would create serious injustice for Canadians who are transferred abroad in the course of their employment. Many of our most active and aggressive companies will have employees who will be in this category from time to time. No other country of which we are aware attempts this kind of taxation. The person who is moving to avoid taxation on gains accrued in Canada may well move abroad in any event and simply not pay the tax.

Other Personal Assets

4:40 It seems to us inappropriate to attempt to tax gains upon the disposition of personal assets unless the value of the assets is significant enough to permit enforcement. In practice this seems to us to call for a minimum level of about $5,000. Furthermore, we believe that the basis of tax should not be more than the capital gain rate which we propose for other capital assets. The provision for losses should provide for an indefinite carry forward.

Taxation of Non-Residents

4:41 The proposed taxation of non-residents on capital gains is as far as we can see unprecedented and we believe unsound and unworkable. Furthermore, it is the kind of proposal which will deter investment by foreigners particularly in the financing of new ventures with Canadian participation in ownership. It should be abandoned.

* * *

4:42 For the foregoing reasons, we submit that a different basis of taxing gains and losses on the disposition of capital assets is required.

4:43 In summary we submit:

(a) that net gains on capital assets as realized should be taxed at not more than 15%;

(b) that while losses should be deductible from gains, any off-set of losses against normal income must be restricted;

(c) revaluation every five years should be abandoned;

(d) that unabsorbed losses be available to be carried forward against future gains for an indefinite period of time;

(e) that no tax be applicable on gains on the sale of a principal residence;

(f) the proposal to tax deemed realization e.g., gains on giving up Canadian residence be abandoned;

(g) that only gains on the disposition of articles of personal use and enjoyment having a value in excess of $5,000. be taxed, and then at capital gains rates, and losses only be deductible against gains on articles of this nature;

(h) that capital gains tax be realized upon death and recognized as a liability of the estate; at the same time estate tax rates be adjusted downward to recognize the incidence of capital gains tax;

(i) the proposal to tax non-residents upon capital gains be abandoned.

* * *

CORPORATIONS AND SHAREHOLDERS

White Paper Proposals

- Withdrawal of low rate on the first $35,000.;
- Creation of two separate classes of corporations;
- Transitional provisions to identify the shareholder of the closely-held corporation with the assets of the corporation;
- Allocations of tax (subject to limitations) paid by the corporation wholly or partly as if paid by shareholder;
- Complicated proposals with respect to the taxation of intercorporate dividends;
- Dependence upon rough equivalence of maximum personal and corporate rates of tax.

Comment

5:1 We question the introduction of a conceptual framework which is radically different from the present (and from other major tax systems) unless the conceptual framework is clearly established to be essential to the reasonable objectives of reform.

5:2 We question the adoption of this radical conceptual framework when it appears to be founded upon false appreciation of the nature of corporation income, false assumptions as to the structure of corporate enterprise and unrealistic assumptions as to the permanence of rate levels whether personal or corporate.

5:3 We believe that the introduction of this conceptual framework will occasion great uncertainties as loopholes appear and are closed. The present tax structure may require modification, but is not, as suggested in the White Paper, rife with loopholes. In any event, the loopholes are all presently recognized and can be effectively dealt with within our present structure.

5:4 We question the adoption of this radical conceptual framework when it is this framework rather than substantive tax proposals which causes many of the difficult problems of transition and administration.

5:5 The proposals do recognize a problem with respect to the liquidation of corporate surplus in the closely-held company and propose a means which eases this problem, at the cost of a uniform 50% rate on all corporate profits. In our opinion it is not necessary to impose the White Paper concepts to resolve this problem.

5:6 We believe that an extension of the present tax structure using the dividend tax credit and capitalization of corporate surplus presently permitted in the act can accomplish the purpose of the White Paper with respect to closely-held companies, without relating corporation tax paid to the tax of the shareholder or imputing the income of the corporation to be the income of the shareholder.

5:7 Corporation income should be taxed on a realistic basis

and corporate distributions should be taxed on a realistic basis.

5:8 The idea that income of a corporation reinvested in the business is income of the shareholder is unsound, as is the idea that it is available for the personal use of the shareholder, and equally that the assets of the corporation can be identified with the shareholder. The value of a business is related more to the prospective earning capacity of the enterprise as a going concern than to book value of the assets, or the market value of the assets sold separately.

5:9 The proposal to link the taxation of the corporation with tax paid by the shareholder is surprising, since a similar concept in effect in the United Kingdom for over a century, was finally abandoned in 1965. (i) The necessity to reinvest profits, to encourage and favour growth and the unreality of linking the shareholder precisely with the corporation were the motives which moved the change. If this reasoning is sound, then the proposals of the White Paper favour dissipation of profits and penalize growth.

Specific Difficulties

5:10 It is necessary to recognize the general contribution that is borne by corporations in the tax treatment which is afforded

(i) *710 H of C Report Cols. 254 - 256*

to corporate distributions to shareholders; but the proposal to precisely link the shareholder with the corporate tax paid, along with the necessity to distribute income within two and one-half years to obtain the gross up and credit for tax paid causes the gravest distortions and complications.

(a) In portfolio management for income the investor needs to be able to predict as nearly as possible what the income consequences to him will be. To do that he or his advisors will assess the gross income likely to be forthcoming based upon contractual commitments and projected dividend policies. Many investment grade dividend paying companies are in cyclical industries whose investment quality has been attained through strong financial management and regular dividends. The investor would be expected to assess not only the long-term strength of the company in relation to its established policies, but also its year-to-year position on its income tax, a task the company itself would find difficult. This problem extends to companies in many industries, in which by reason of incentive, capital cost allowance or other feature of the income tax act, the corporation will be paying dividends during periods when there may have been no corporate tax paid. If there is a

problem here, surely it is between the corporation and the tax authorities, and the shareholder ought to have no part of it.

(b) The next absurdity which results from this proposal is the creation of a tax on inter-corporate dividends which causes considerable complexity and which appears to intend that normally no tax would be paid although there are cases, of course, where there would be and should not be. It seems a very convoluted method to accomplish what is already the case under the present law.

(c) Another difficulty raised by this aspect is discrimination against corporate income abroad. We believe that there are other social and economic objectives to the promotion of Canadian enterprise than the generation of revenue for government. Certain Canadian companies and industries have developed skills and expertise which can be usefully employed abroad, in providing useful contributions to the economic welfare of the foreign country. In other cases, foreign operations may be an essential complement to the operations of the Canadian company in Canada. To penalize the shareholders of these companies because the company is expanding opportunities and providing income for Canadians is a

negative policy.

(d) The gross up and credit approach will also result in the anomalous position that the tax structure or government policy will create incentives for the corporation to undertake an activity or to locate it somewhere while the incentive will be swept away at the shareholder level. It seems pointless to begin with and contrary to the apparent identification of shareholder with corporation. If the government considers it to be good for the corporation, why should it consider it bad for the shareholder? In particular, this proposal would seriously distort normal and sound business practice in mining companies since the depletion allowance incentive will be destroyed on the payment of dividends. Complicated schemes would be devised to use up depletion and re-cycle income to any company where unused depletion was perhaps the only asset.

(e) Another effect may be the distortion of dividend and capital patterns in order to pass on creditable tax to shareholders before it expires. We might agree that shareholders could reinvest earnings better than some companies but such reinvestment is not accomplished without cost. Forced distributions would create serious conflicts of interests between shareholders. Distortions

of dividend or capital patterns have not been shown generally to be desirable. The adoption of a tax structure designed to dissipate earnings rather than reinvesting them might well be postponed until such desirability has been established.

(f) The proposals with respect to "closely-held companies" are in many respects favourable to their shareholders but there are a great many problems and inequities which arise in the transitional period - the retroactive aspects on the taxation of capital gains, the distribution of earnings within the two and one-half years among them. They result primarily because of the identification of company and shareholder.

(g) The proposals would have the effect of seriously discriminating against the shareholders of certain utility companies or other companies which do not now or may not in future pay federal tax. The tax situation of the company arises from a combination of federal and provincial policies. Why the shareholders of these companies should be singled out for discrimination because of an aspect of deliberate policy of the government is difficult to understand. The proposals make equity financing of these companies in Canada extremely difficult.

(h) It is this concept which makes it particularly difficult to provide any fiscal incentives to small businesses. We believe that the provision of fiscal incentives for small businesses should be considered as a separate problem and not precluded because of symmetry.

5:11 Many of the most serious and arbitrary consequences in the proposals arise from the gross-up and credit approach to the corporation and its shareholders. The approach should be abandoned and the reasonable objectives of this approach should be attained through a lowering of tax on corporate distributions.

5:12 Part of the logical structure supporting the gross-up and credit appears to be the maximum personal tax at 50% and the uniform corporation tax at 50%. The assumption of permanence of either personal or corporate rate, which provides much of what logical support there is to this part of the proposals, is invalid. The dependence of the corporation - shareholder tax structure upon a uniform 50% corporate tax rate is unrealistic. If any major shift in revenue is made by our principal trading partners from corporation income tax to tax on value added, it will destroy the 50% corporate rate in Canada.

5:13 The maximum personal rate of 50% seems unrealistic in view of provincial fiscal requirements.

Closely-Held Concept

5:14 The proposals with respect to closely-held companies and their shareholders - that is, the complete integration of shareholder and company with one income tax at a maximum of approximately 50% - recognizes a very real problem in our present structure, the withdrawal of surplus from the closely-held company. The proposals are designed to stop the accumulation of surplus taxed at the corporate level and subsequent evasion or avoidance of tax on removal of surplus and substitute "a once and for all tax" of 50%.

5:15 We believe this concept, if implemented, would operate very favourably for the proprietors of our firm, a large closely-held organization. Nonetheless we find it impossible to rationalize the distinction made in the White Paper between closely-held companies and widely-held companies, certainly not in the area of competition. The larger grain companies for example, include public investor companies, private companies, American-owned companies, three wheat pools and a farmer-owned public company. Canada's largest retailer would be closely-held, but competes with publicly owned Canadian department stores, a well established public company incorporated in England and with most major retailers in the cities in which it does business. The corner grocer may compete with another corner grocer who may in turn be a franchised manager of a public company, but

both compete with the larger supermarket.

5:16 We do not believe the proposed distinction in classes of companies can be justified. We believe the problems of closely-held companies relate to the need to withdraw surplus at reasonable cost to make provision for orderly transfers of ownership of enterprise and to make provision for estate tax liabilities; such withdrawals may not initially involve cash. The problems should be resolved on the distribution of corporate surplus, whether by dividend or capitalization, which would be available to any corporation, rather than through discriminatory flow-through provisions.

Consolidated Returns

5:17 Since we are proposing to eliminate the partnership option, we recommend provision for the filing of consolidated returns be permitted by associated companies.

Corporation Tax Rates

5:18 As has been pointed out, one of the basic assumptions of the White Paper concepts was the permanence of the 50% tax rate on corporate income. As an assumption, it is subject to invalidity from changing revenue requirements, both at the federal and provincial level.

5:19 It must be challenged immediately by the competitive rates of tax on corporate income in the countries with which we trade.

These rates vary between 50% and 53% in Canada and are or will be as high or higher than most of our competitors.

5:20 The corporation tax is a very useful tax: it attaches to large revenue flows, is easy to administer, and in relation to the revenue generated, is inexpensive to collect. Once we move outside of Canada, however, the relative rates of corporate tax become significant. It then becomes a burden which affects our producers in competing abroad against firms of countries with lower rates and again competing against such firms in our own markets. One quarter of our national product involves foreign trade. Our tax structure must be such that foreign firms do not have a tax advantage in our markets and we are not disadvantaged in their markets. It must have flexibility to meet economic conditions as well as changing requirements for revenue.

5:21 Under our proposals we believe that some, though not great, disparity in tax level between the maximum corporate rate and maximum personal rate is necessary in order to avoid the proliferation of partnerships when in fact the corporate form might be more desirable for business reasons. This is another reason for considering lowering corporate income tax, but we believe that such a step is inevitable if international trends in corporate taxation continue.

Co-operatives

5:22 The White Paper proposes that:

- The three year tax exemption for new co-operatives be removed;
- The deduction of patronage dividends be limited to an amount which would not reduce profits before the deduction of interest paid on members' loans and capital to a figure less than a percentage rate (of members' loans and capital) which would be related to current government bond interest.

5:23 As there is no similar tax exemption for new businesses which organize themselves in a corporate form other than a co-operative, the removal of the three year exemption would appear to be reasonable.

5:24 The suggestion that the percentage rate, presently 3%, would vary from year to year with the rates paid on government bonds is a realistic approach to this problem when combined with the proposal with respect to interest paid on members' loans and capital

5:25 The percentage rate should be applied to all loans and equity whether capital or reserves, and to be deductible, the amount be paid in cash. For revenue purposes it would also be important that these interest payments be reported on the same basis as other interest and dividends. This comment applies as well to patronage payments, presently reported only if $100. or more, compared to $10. for other investment income.

* * *

SMALL BUSINESS

White Paper Proposals

- The phased withdrawal of the low rate of tax on first $35,000. of corporate income.

- The granting of a partnership option to corporations so that income can be allocated to the proprietors at rates below 50%.

Comment

6:1 Small business operates in a rather inhospitable climate as far as capital is concerned. While sources of capital may exist for the purchase of machinery and plant, only limited finance is ordinarily available to finance working capital requirements. Capital cost allowances only help if the firm has significant depreciable property but it is not significant for many secondary manufacturers whose problem is the financing of work in progress, inventory and accounts receivable. There is a very narrow source of equity capital for small new ventures - certainly not the public, and thus the generation of internal capital is very important to small business.

6:2 The loss of the lower rate to incorporated business will seriously affect the finance of domestic industry in its formative stages, particularly as it just begins to be successful.

6:3 The United States provides a lower rate of corporate income tax upon the first $25,000. of taxable income.

6:4 We recognize that there are incorporated enterprises which do not have capital requirements and for whom the lower corporate rate represents a substantial tax advantage over salaried and unincorporated professional persons. We also recognize that the lower rate is not a concession which is significant to larger enterprise.

6:5 We regret that the White Paper proposes to remove an essential source of internal finance without any measure to replace it. It would be possible to limit the low rate to companies with small taxable income, say $100,000. or less, and apply the 50% rate on total income of larger enterprise through a "notch" provision. Alternately, a credit against tax, related to reinvestment in the business of the company might refine the proposal even further and act as a spur to growth. A limit on total accumulation or time of accumulation might be adopted.

6:6 The proposed partnership option is of no significant value except that it will permit active proprietors to offset losses against other income (if any) without losing limited liability. It is open to investors to enjoy loss privileges with limited liability now through limited partnerships. Shareholders in small business will have any profits added to their income for services or other income and be taxed at marginal rates. The scope for internal generation of capital would be thus very limited.

6:7 We recommend that the lower rate upon corporate income be retained for corporations with taxable income under $100,000., at least until alternative devices to assist capital formation for small business have been introduced.

* * *

MINING & OIL

White Paper Proposals

- Removal of three year tax exemption - fast write-off of assets permitted.
- Depletion for operators on "earned" basis rather than flat percentage of income.
- Depletion for non-operators removed.
- Depletion for shareholders removed.
- Exploration and development expenses deductible for non-principal business.
- Removal of special incentives for prospectors and grubstakers.

Comment

7:1 These industries must really speak for themselves for an exposition of their problems as they relate to these proposals but there are certain areas where we feel qualified to comment.

7:2 Many countries in their taxation policies have recognized that, due to the high risks and large amounts of capital employed these industries cannot be treated on the same basis as other industries. Canada has for a number of years been one of the countries that recognizes these factors and, as a result, these industries have made an immense contribution to the economic development of Canada, particularly in the last twenty years. It

is unrealistic to take a theoretical approach to their present tax position and claim that they are capable of producing more tax revenue, whereas it is very likely that they would not have existed in their present form, and be making their present important contribution if they had not been provided with incentives.

7:3 These industries tend to be linked together in terms of problems and treatment. They are very different industries, however, with different problems of exploration, development, capital and marketing.

7:4 The financing of production of proven oil reserves is much simpler than financing a new mine. The significance of depletion for exploratory oil companies is relatively minor.

7:5 The financing of a new ore body is normally subject to very great uncertainty: uncertainty of capital costs and overruns, uncertainty in ore grades, uncertainty of recoveries, uncertainty in production costs and uncertainty as to prices of product. The development work and feasibility studies must indicate adequate margins over and above cash flow to service debt in order to justify the risks being assumed.

7:6 The development phase normally requires very large capital expenditures. A tax free period, perhaps limited as to amount, may still be desirable to increase cash flow in the early years of a mine and reduce the risk of new mine development. However, the fast write-off of assets appears to be a useful concept and should

be an efficient and realistic economic mechanism, particularly in encouraging development of larger low grade ore bodies.

7:7 The White Paper proposals do not appear to take into account the impact of provincial mining taxes or competitive sources of minerals in countries such as Australia, where the tax climate is more advantageous than is contemplated by the present proposals. A minimum depletion may be necessary to take these into account. The concept of so-called earned depletion may also be a useful incentive but the ratio of 1 to 3 does not appear sufficient in itself. The depletion base in the case of mining companies appears far less adequate than that of oil companies.

7:8 The question of depletion and rate of tax generally is relevant to the exploratory effort, while the tax-free period affects the economics of bringing discoveries into production. Both are important, but in the long run, it is probably depletion which is more significant.

7:9 The withdrawal of depletion to shareholders of mining companies seems unfounded, because where the dividend is in fact a return of capital, capital losses under the White Paper proposals, will not provide the proper offset.

7:10 The incentive to prospectors and grubstakers should be retained but modified to be taxable at capital gains rates.

7:11 The whole concept of creditable tax destroys and immensely complicates the transfer of the benefit of depletion and similar

incentives. It should be abandoned to provide tax free flow of dividends between corporations and uniform treatment of dividends in the hands of shareholders.

* * *

INTERNATIONAL

White Paper Proposals

- Taxation of capital gains of foreigners.
- Taxation of passive investment income of residents.
- Attempt to tax recapture of branch profits.
- Withdrawal of tax credit for dividends of foreign corporations operating in Canada.
- Revise all tax treaties to suit our system.
- Withholding taxes increased to 25% (except in treaty countries where 15%).
- No creditable tax on dividends except for credit for 15% withheld abroad, if applicable.

Comment

8:1 It is a generally recognized principle of taxation that gains of foreigners derived from a country are only taxable in that country if they are attributable to a permanent establishment. It seems incredible that Canadians who have one of the most open economies in the world for capital and trade should expect the world to turn recognized practice upside down.

8:2 It also seems extremely inconsistent to attempt to tax our own citizens upon gains realized on assets held abroad and to tax gains of foreigners realized on assets held here.

8:3 The attempt to tax substantial investment of foreigners is likely to be counter-productive firstly because it will discourage foreign investment and secondly, because the foreigner can easily take steps to avoid the tax through the use of holding companies. It seems a strange reward for those foreign investors who answered the "Degree of Canadian Ownership" appeal.

8:4 There are many examples of effective partnership between Canadian investors and foreign capital where the foreign investor has been able to make an essential contribution to the advancement of enterprise managed by Canadians and providing opportunities and employment for Canadians. Frequently the foreigner provides some essential factor as well as capital - e.g., markets or technology - without which a project cannot be completed.

8:5 The discrimination against venture abroad by Canadian enterprise is also shortsighted. There are areas such as mining, oil exploration, and other key industries where Canadians have accumulated skill, technology and capital. We should encourage the exercise of our skills to the benefit of opportunities for Canadians, income for Canadians, and benefits to the foreign country.

8:6 It is possible that the concept of creditable tax will provide roughly equivalent tax treatment for dividends arising from earnings from countries which have withheld 15%. It does nothing, however, for the earnings in developing countries where our contribution would be of value, at least to ourselves, and where tax concessions

might have been made. Such developments will no doubt be made, but probably not by Canadians and we will be the poorer for not having made them, and the developing country will be poorer for not having our competition available.

8:7 The proposal to fully tax gains in shares of companies held abroad will likely be seriously counter-productive of revenue in the case of foreign subsidiaries, as the successful ones will not be realized, but losses certainly will be.

8:8 The proposal to increase withholding tax rates seems to assume that this will pressure other countries to agree to our type of tax treaty. Since we are substantial importers of capital, and likely to remain so, the more likely effect will be to increase the cost of imported capital to cover the additional cost of withholding tax.

8:9 The White Paper proposes to remove dividend tax credit provisions as they apply to foreign companies resident in Canada. No justification is given. Companies incorporated in certain countries cannot re-incorporate because of punitive tax consequences abroad.

8:10 The White Paper does not establish that there are any abuses in the international area which require, or are capable of, correction by their recommendations. These proposals should be dropped.

* * *

PROVINCIAL TAXATION

White Paper Proposals

- In personal income the provinces' present 28% abatement has been given up. While the provinces are free to assess their own income tax, personal rate schedules have been prepared on the basis of 22% of the actual federal tax proposed.
- The federal government will collect the provincial tax provided the provincial tax is expressed as a percentage of federal tax.
- The abatement of 10% relating to corporations will continue.

Comment

9:1 The effect of the tax changes if fully implemented on the basis of 1969 incomes appears to be a substantial increase in tax. If the provinces fit within the overall structure, as contemplated by Chapter 2 of the White Paper, they would not receive less revenue than at present, but they do not share significantly in the increase.

9:2 The change in calculation effectively reduced the provinces' abatement from 28% to about 22% - that is, the federal share of the "ideal" personal tax burden becomes 78% instead of 72%. Since the provinces are no worse off in revenue terms, this means that the bulk of the increase in tax accrues to the federal government. The provinces are kept in the same current position

including within their participation specific taxes at the lower and most broadly based levels.

9:3 While the rate schedule has become more progressive upon the middle class the provinces' percentage share of increasing revenues will decline while the revenue accruing to the federal government will accelerate.

9:4 The proposals would reduce the provinces' personal tax base by increasing personal exemptions, reducing the percentage share of increasing income and retaining the increase in tax revenues from the corporate sector for the federal level. As a result the surtaxes upon income which they are likely to impose will have to be exaggerated to raise the required revenue.

9:5 The requirement that provincial tax be a fraction of federal tax accelerates the progression of the rate structure in the event that the provinces tax at above the expected level.

9:6 For example, if the expected level of provincial is 20% and turns out to be say 50%, the take home income of the 20% federal taxpayer is reduced at the margin by about 8%, for the 40% federal taxpayer, his take home pay at the margin is reduced 23%. This example may be exaggerated but the present 11% surcharge in Manitoba operates as a 2.2% tax on income at the 20% rate, 5.5% at the 50%, and at about 8.9% at the highest basic rate of just over 80%.

9:7 The provisions with respect to flow through and closely-held

companies, if adopted, could make residence in provinces levying tax at sur-tax levels prohibitive for persons who have attributed income over which they do not have disposition.

* * *

OTHER

Farms

10:1 Due to the current depressed markets for grain, land values in Western Canada have suffered a decline. As this situation may prevail at the time values are established for capital gains purposes, we recommend that gains be taxed only from the cost or value on valuation day whichever is higher.

10:2 While we have recommended that the tax on capital gains on principal residences be eliminated, we recognize that this approach is not suitable when applied to the sale of a farm with farmhouse that has been a principal residence. We therefore support the proposal of a per annum exemption for farms which are principal residences as provided in the White Paper.

10:3 We emphasize in the farming area our general recommendations with respect to capital gains and that estate taxes should be reduced so that the total capital gain and estate tax would not exceed the present burden.

Goodwill

10:4 We believe the proposals in respect to goodwill are arbitrary and could prove to be unfair in certain circumstances. We recommend goodwill be treated as follows:

(a) As a depreciable asset where the cost of the asset could be claimed as expense over ten years on a straight line basis and any recapture on sale to be classified as income.

(b) Any proceeds on the sale of goodwill in excess of original cost be taxed as capital gains.

(c) The fair market value of any goodwill at valuation day would not be subject to tax in the event of sale except to the extent it has been deducted against taxable income.

Real Estate

10:5 The White Paper proposes that:

- No deduction be permitted from other income for a loss from holding real property if that loss is created by capital cost allowance.

- No deduction be permitted arising from holding real property if the losses are created by interest or property taxes.

- Any building costing in excess of $50,000. be segregated in a separate depreciation class.

- Beneficiaries inheriting a property would for tax purposes inherit the capital cost of the property to the deceased.

10:6 The combined effect of the above proposals is to discriminate against investment in rental property as compared to investment in any other form. The owner of an investment property may, because of economic conditions at a particular time or through other factors,

suffer a substantial loss on the holding of a real estate property, and we see no reason why actual costs incurred to produce taxable income should not be deductible.

10:7 The result of implementing discriminatory provisions of this nature would seem to be that apartments and other rental property would become more expensive to rent and the amount of construction would be reduced as investors look for other forms of investment. This comes at a time when Canada is encountering a very high rate of family formation and there is a great social need for more housing.

10:8 If there is a problem in the present tax structure, it arises from the method of determining income and any changes should be made in this area and not through arbitrary exclusion of expenses.

10:9 In the capital gains section of this submission, we recommend that all capital gains be deemed to be realized at death. Based upon this recommendation, any unrealized gain in real estate at the date of death would be subject to capital gains tax and the beneficiary would then take over the asset at fair market value and depreciate on that basis.

Trusts

10:10 The White Paper proposes that trusts be taxed in future at the corporate rate rather than being taxed at the individual income tax rates as in the past. In many cases trusts have been established

either by inter vivos gift or by will under which the terms of the trust cannot be changed. Any drastic change in the basis of taxing these trusts, would place an unfair tax penalty upon the ultimate beneficiaries of the trusts.

10:11 If there are particular abuses, we believe they should be covered specifically rather than being covered by a change in the overall taxing philosophy.

Taxpayers in the Professions

10:12 The Income Tax Act presently permits taxpayers in the professions to follow a cash basis of accounting, and the White Paper suggests that this gives this class of taxpayer an unwarranted advantage by comparison to the rest of Canadians.

10:13 We believe that the proper comparison of taxpayers in the professions is with professional individuals who are employed by business, or indeed other employees.

10:14 We believe that taxpayers in the professions should be entitled to continue using the cash basis.

Entertainment, Convention and Related Expenses

10:15 It is proposed in the White Paper that no deduction be allowed for entertainment expenses, the cost of attending or sending employees to conventions and the cost of dues for membership in social or recreational clubs. We do not believe that deduction

should be denied to any genuine business expense which has been laid out for the purpose of earning income.

Pension Plans and Retirement Savings Plans

10:16 The White Paper proposes that at least 90% of the assets of pension plans and retirement savings plans be invested in Canadian securities.

10:17 There are many sectors of industry which are not represented by Canadian securities. For pension fund or retirement fund trustees to maintain a balanced portfolio they should have the flexibility of being able to invest in foreign securities. Foreign holdings will not usually be large because the withholding tax provides a bias towards Canadian securities. Further incentive should be unnecessary.

10:18 If the proposals were adopted, trustees representing millions of Canadians would be prevented from taking steps to protect the assets of their funds at times when the Canadian market was dropping. Furthermore, by locking these assets into Canadian securities a stabilizing factor would be removed from the market place.

10:19 The White Paper proposes pensions paid from Canada to persons living outside would be subject to a withholding tax of 25% with provision for higher or lower rates.

10:20 We oppose the deduction of a withholding tax which may further affect a retired person's standard of living which, in most instances, is reduced on retirement. This income is normally fixed for life

subject to a further decline in the standard of living through inflation.

10:21 We recommend that both proposals be abandoned.

* * *

CONCLUSIONS

11:1 We have attempted to cover most of the major changes outlined in the White Paper, but it is impossible to be comprehensive in dealing with a document which contemplates such extensive alteration in our existing tax environment. We have concluded that the economic effects of the proposals (insofar as they can be estimated) would be contrary to the long term interests of Canadians. We believe that the proposals respecting corporations and their shareholders recognize some of the existing problems in the tax law, but the solutions propounded have very great shortcomings, both in principle and in application. We consider the proposed basis of taxation of capital gains to be unfair and discriminatory. The proposals do not recognize the burden presently imposed on the middle class. The proposals do not recognize the needs of the provinces. Certain minor proposals seem unwarranted or certainly unjustified on the basis of the arguments presented in the White Paper.

11:2 Inasmuch as the proposals do recognize some of the problems of our existing tax structure, it seems fair to suggest why they are less than successful in their solutions.

11:3 We believe that the task which the draftsmen were given was of such sweeping character that it was impossible for them to relate their proposals to all of the varied circumstances to which they were to be applied. The decision to attempt social reform and

a tax increase along with tax reform added to the magnitude of the problem, particularly in assessing the economic consequences of the proposals.

11:4 We have pointed out a number of problems in connection with the major proposals and we believe them to be serious. There are undoubtedly other problems because we have found that others have discovered inequities or difficulties which we overlooked. This is because it is impossible for a small group of experts in the Department of Finance, or elsewhere, to invent a radically new tax system that can be fairly imposed upon the diverse structure of interests in Canada, or realistically to assess its effects.

11:5 This does not mean that we must abandon the goal of tax reform nor does it mean that reform should be referred for ultimate solution to yet another group of experts.

11:6 It does imply that we must be prepared to look for reasonable approaches to known problems rather than radical solutions to all conceivable problems at once. It is only by such a procedure that reform proposals can be given the examination and review which they require if we are to have a viable and fair tax structure. The task of parliament does not thereby become easy, but at least it becomes possible.

* * *

APPENDIX "B"

NAME: JAMES RICHARDSON & SONS LIMITED

SUBJECT: The White Paper Proposals

Analysis of Appendix "A" by Senior Advisor

This brief has been submitted by James Richardson & Sons Limited and its Associated companies. Richardson Securities of Canada, the securities affiliate of James Richadson & Sons, Limited is one of the largest securities firms in Canada.

The areas of activity encompassed by other Richardson companies include grain elevators and terminals, grain merchandising and related enterprise, insurance brokerage and insurance, real estate and real estate development, specialized forms of contracting, and farming, These include both relatively large and small enterprises.

Within these enterprises there are personnel with experience which may be of assistance to the Parliamentary Committees in their study of the Government White Paper, Proposals for Tax Reform. In particular, we considered that Richardson Securities of Canada could help assess the proposals in their impact upon securities markets, public companies, the raising of funds for enterprise and on the economy generally.

It is also stated that the brief is not intended to promote the interests of any particular segment or economic group. We hope that it will assist you in your efforts to devise an appropriate tax structure for Canada.

The Brief itself comprises:

(1) An introductory chapter commenting generally on the White Paper proposals (Pages 2 and 3)

(2) A chapter dealing with the economic impact of the White Paper (Pages 4 to 12.)

The conclusions of this chapter follow "2.17 In conclusion, we question the contention in the White Paper that the economic impact of the proposals would be minimal. It seems obvious they would have a substantial detrimental impact on private savings and investment in the Canadian economy. Since investment is the prime generator of economic growth it is clear that the Canadian economy would not achieve a growth rate as high as it would have under the existing taxation system. This we feel, is detrimental to the welfare and prosperity of every Canadian - whether he is a member of the lower, the middle, or the upper-income group. The best way to improve the well-being of all Canadians is through the generation of a high rate of economic growth. This will do far more to benefit the lower-income group than a small per capita tax decrease.

(3) Special chapters dealing with the following specific aspects of the White Paper.

(a) Personel Income Taxes

(b) Scholarships

(c) The Capital Gains Tax

(d) Corporations and Shareholders

(e) Consolidated Income Tax Returns

(f) Corporation Tax Rates

(g) Co-operatives

(h) Lower rate of tax on first $35,000 of taxable income of corporations

(i) Mining and Oil Companies

(j) International Income

(k) Provincial Taxation

(l) Farmers

(m) Goodwill

(n) Capital cost allowances on rental Real Estate

(o) Trusts

(p) Cash or accrural Basis of Computing Income

(q) Entertainment and Related Expenses

(r) Pension Plans.

The conclusions of the brief follow:

"We have attempted to cover most of the major changes outlined in the White Paper, but it is impossible to be comprehensive in dealing with a document which contemplates such extensive alteration in our existing tax environment. We have concluded that the economic effects of the proposals (insofar as they can be estimated) would be contrary to the long term interests of Canadians. We believe that the proposals respecting corporations and their shareholders recognize some of the existing problems in the tax law, but the solutions propounded have very great shortcomings, both in principle and in application. We consider the proposed basis of taxation of capital gains to be unfair and discriminatory. The proposals do not recognize the burden presently imposed on the middle class. The proposals do not recognize the needs of the provinces. Certain minor proposals seem unwarranted or certainly unjustified on the basis of the arguments presented in the White Paper.

Inasmuch as the proposals do recognize some of the problems of our existing tax structure, it seems fair to suggest why they are less than successful in their solutions.

We believe that the task which the draftsmen were given was of such sweeping character that it was impossible for them to relate their proposals to all of the varied circumstances to which they were to be applied. The decision to attempt social reform and a tax increase along with tax reform added to the magnitude of the problem, particularly in assessing the economic consequences of the proposals.

We have pointed out a number of problems in connection with the major proposals and we believe them to be serious. There are undoubtedly other problems because we have found that others have discovered inequities or difficulties which we overlooked. This is because it is impossible for a small group of experts in the Department of Finance, or elsewhere, to invent a radically new tax system that can be fairly imposed upon the diverse structure of interests in Canada, or realistically to assess its effects.

This does not mean that we must abandon the goal of tax reform nor does it mean that reform should be referred for ultimate solution to yet another group of experts.

It does imply that we must be prepared to look for reasonable approaches to known problems rather than radical solutions to all conceivable problems at once. It is only by such a procedure that reform proposals can be given the examination and review which they require if we are to have a viable and fair tax structure. The task of parliament does not thereby become easy, but at least it becomes possible."

There is attached the usual summary of present tax laws, White Paper proposals and principal points of the brief.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Personal Income Taxes

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not relevant	The White Paper proposals respecting personal income taxes are contained in Chapter 2 of the White Paper.	Pages 13 to 22 of the brief This portion deals in considerable detail with the proposals of the White Paper relating to personal income taxes and rates. This section submits some very useful comparisons of taxes in Canada and the United States.

Name: James Richardson & Sons Limited

Principal Subject: Scholarships

Present Tax Law	White Paper Proposals	Principal Points of Brief
Generally, the present Income Tax Act does not levy any tax on scholarships received by students	**1.37** **It is also proposed, in fairness to other taxpayers, that fellowships, research grants, scholarships and bursaries be treated as taxable income but subject to the deduction for tuition fees and costs incurred for research. Undergraduates would seldom need to pay tax because few scholarships and bursaries are larger than the new personal exemptions plus the fees that may be deducted from students' incomes. But if students have other income, there is no reason why they should not be taxed like other Canadians.** 2.24 Until now most fellowships, scholarships, bursaries and research grants not related to services have been treated as exempt from tax. There seems no valid reason for continuing such exemption. Post-graduate students and research workers are, in effect, professional workers and should pay tax as others, after allowances for tuition fees and for research expenses properly deductible from research grants. Payments to undergraduates normally fall well within the personal exemptions, after deducting tuition fees. Where they exceed exemptions or where the student has other income, he should pay tax just as other Canadians do.	This portion of the brief states: 3:18 The White Paper proposes to treat scholarships and bursaries as taxable income. It is apparent that the size of these awards are presently determined in part by the fact that their receipt is non-taxable. Existing charitable sources which supply these funds may have difficulty increasing awards to offset the impact of tax. Provincial governments are another major source of bursaries and scholarships. An increase in provincial bursaries to offset income tax would in effect transfer resources from the provinces to the federal government. This kind of receipt is normally not taxable in the United States or the United Kingdom and it would be anomalous if a bursary or scholarship to study in Canada would be penalized in comparison to the same award to a Canadian studying abroad. 3:19 In view of the foregoing the proposal should be abandoned as there does not appear to be any substantial abuse to be remedied.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Issue: The Capital Gains Tax

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not impose an income tax on capital gains.	The White Paper proposals relating to the taxation of capital gains are contained in Chapter 3 of the White Paper.	Pages 23 to 37 of Brief. This portion of the brief contains the following views: 4:43 In summary we submit: (a) that net gains on capital assets as realized should be taxed at not more than 15%; (b) that while losses should be deductible from gains, any off-set of losses against normal income must be restricted; (c) revaluation every five years should be abandoned; (d) that unabsorbed losses be available to be carried forward against future gains for an indefinite period of time; (e) that no tax be applicable on gains on the sale of a principal residence; (f) the proposal to tax deemed realization e.g., gains on giving up Canadian residence be abandoned;

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: The Capital Gains Tax

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(g) that only gains on the disposition of articles of personal use and enjoyment having a value in excess of $5,000. be taxed, and then at capital gains rates, and losses only be deductible against gains on articles of this nature;
		(h) that capital gains tax be realized upon death and recognized as a liability of the estate; at the same time estate tax rates be adjusted downward to recognize the incidence of capital gains tax;
		(i) the proposal to tax non-residents upon capital gains be abandoned.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Corporations and Shareholders

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act contains no provisions relating to integration of tax.	The White Paper proposals relating to integration of tax are dealt with in special Study No 4 of March 4, 1970.	Pages 38 to 47 of Brief This portion of the brief comments in some detail on the White Paper proposals to integrate tax. In summary this portion of the brief states: 5:15 We believe this concept, if implemented, would operate very favourably for the proprietors of our firm, a large closely-held organization. Nonetheless we find it impossible to rationalize the distinction made in the White Paper between closely-held companies and widely-held companies, certainly not in the area of competition. The larger grain companies for example, include public investor companies, private companies, American-owned companies, three wheat pools and a farmer-owned public company. Canada's largest retailer would be closely-held, but competes with publicly owned Canadian department stores, a well established public company incorporated in England and

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Corporations and Shareholders

Present Tax Law	White Paper Proposals	Principal Points of Brief
		with most major retailers in the cities in which it does business. The corner grocer may compete with another corner grocer who may in turn be a franchised manager of a public company, but both compete with the larger supermarket. 5:16 We do not believe the proposed distinction in classes of companies can be justified. We believe the problems of closely-held companies relate to the need to withdraw surplus at reasonable cost to make provision for orderly transfers of ownership of enterprise and to make provision for estate tax liabilities; such withdrawals may not initially involve cash. The problems should be resolved on the distribution of corporate surplus, whether by dividend or capitalization, which would be available to any corporation, rather than through discriminatory flow-through provisions.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: CONSOLIDATED INCOME TAX RETURNS

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not provide for the filing of consolidated income tax returns.	5.22 The government considers that its proposal whereby a corporation can be treated as a partnership would permit groups of corporations to achieve the same result as they would under consolidated returns. Therefore, the government does not propose to provide for consolidated returns as such.	Page 47 of Brief This portion of the brief states: 5:17 Since we are proposing to eliminate the partnership option, we recommend provision for the filing of consolidated returns be permitted by associated companies.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Corporation Tax Rates

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not Relevant	The White Paper proposes that eventually corporation income taxes will be set at 40% by federal authorities and at 10% provincial authorities.	Page 47 of Brief This portion of the Brief states: 5.20 Our tax structure must be such that foreign firms do not have a tax advantage in our markets and we are not disadvantaged in their markets. It must have flexibility to meet economic conditions as well as changing requirements for revenue. 5:21 Under our proposals we believe that some, though not great, disparity in tax level between the maximum corporate rate and maximum personal rate is necessary in order to avoid the proliferation of partnerships when in fact the corporate form might be more desirable for business reasons. This is another reason for considering lowering corporate income tax, but we believe that such a step is inevitable if international trends in corporate taxation continue.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Co-operatives

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 73-1 of the Income Tax Act This section grants an exemption from tax for a period of three years to new co-operative enterprises. Section 11-1-n of the Income Tax Act. This section permits patronage dividends to be deducted from income, as long as there remains income equal to 3% of capital employed.	4.68 Two rules in the act have a special significance for co-operatives. One provides that a co-operative shall be exempt from income tax for the first three years of its existence. It is proposed that this exemption be withdrawn. If the rules that govern the tax position of co-operatives in the fourth and subsequent years are fair, they should apply to the first three years as well. 4.69 The second rule provides that patronage dividends are deductible in computing the taxable income of the co-operative, subject to a limit. Patronage dividends are deductible before interest paid (other than interest to a bank or credit union) and cannot reduce profits at that point in the computation below 3 per cent of capital employed. This might be thought to ensure that members are taxed on some return on their investment in the co-operative. However, the 3 per cent is far too low in current circumstances. Further, because such other debts as mortgages are taken into account in determining the capital employed, the effective interest taxed to members can be even lower than 3 per cent. (A $200,000 mortgage at an interest rate of 7½ per cent would result in no taxable return on members' investment of $300,000.)	Page 48 and 49 of Brief This portion of the brief states: 5:23 As there is no similar tax exemption for new businesses which organize themselves in a corporate form other than a co-operative, the removal of the three year exemption would appear to be reasonable. 5:24 The suggestion that the percentage rate, presently 3%, would vary from year to year with the rates paid on government bonds is a realistic approach to this problem when combined with the proposal with respect to interest paid on members' loans and capital. 5:25 The percentage rate should be applied to all loans and equity whether capital or reserves, and to be deductible, the amount be paid in cash. For revenue purposes it would also be important that these interest payments be reported on the

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Co-operatives

Present Tax Law	White Paper Proposals	Principal Points of Brief
	4.70 The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans—that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends.	same basis as other interest and dividends. This comment applies as well to patronage payments, presently reported only if $100. or more, compared to $10. for other investment income.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Lower Rate of Tax on First $35,000 of Taxable Income

Present Tax Law

Under the provisions of the present Income Tax Act, the first $35,000. of taxable income of corporations that are not associated corporations is taxed at about 21% while the excess taxable income is taxed at about 52.3%.

See Special Study No. 3.

White Paper Proposals

4.30 It is therefore proposed that the low rate be removed from the business profits of small corporations gradually over a period of five years. For corporations with taxable business profits not greater than $35,000 the low rate would apply to $28,000 in the first year of transition, $21,000 in the second, $14,000 in the third, $7,000 in the fourth, and be eliminated entirely in the fifth year. For corporations with taxable business profits above $35,000, the amount subject to the low rate would be reduced more quickly the more the corporation's taxable profits exceed $35,000. The benefit would be removed immediately if taxable business profits equal or exceed $105,000. In other words, the larger the corporation the more quickly it would lose the benefit designed for small corporations.

4.31 The precise formula would remove 80 cents of a corporation's entitlement to be taxed at the low rate for each $2 of business income in excess of $35,000 in the first year of transition. In the second year the reduction would be 60 cents for each $2; in the third year, 40 cents for each $2; and in the fourth year, 20 cents for each $2. In the meantime the maximum entitlement would be reduced, so that the effect would be a

Principal Points of Brief

Pages 50 to 52 of Brief

This portion of Brief states:

6:7 We recommend that the lower rate upon corporate income be retained for corporations with taxable income under $100,000., at least until alternative devices to assist capital formation for small business have been introduced.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Lower rate of Tax on first $35,000. of Taxable Income

Present Tax Law	White Paper Proposals	Principal Points of Brief
	gradual reduction in the amounts subject to the low rate of tax. For example, a company with taxable business profits of $85,000 in each of the first five years of the new system would be entitled to have $8,000 taxed at the low rate in the first year, $6,000 in the second year, $4,000 in the third year, $2,000 in the fourth year and nothing the fifth year. On the other hand, a corporation that earns $45,000 in each of the first five years would be entitled to have $24,000, $18,000, $12,000, $6,000 and zero taxed at the low rates.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 83 - 5 of the Income Tax Act This section excludes from income the profits derived from the operation of a mine during the first 3 years of its operations. **Part 12 of the Income Tax Regulations** These regulations permit the operator of a resource to reduce net income earned from a resource by 33 1/3%.	1.50 The government has decided that some special rules should still apply in determining the income derived from the mineral industries, in order to encourage exploration for and development of mineral deposits. These inducements are intended to encourage the establishment and growth of highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring. However, the special rules should be revised substantially to ensure that really profitable projects pay a fair share of the national revenues, as other industries do, and that the inducements offered are efficient. 1.51 Two main changes are proposed. The first would replace the three-year tax exemption for new mines with a special rule permitting capital costs of fixed assets purchased for the development and operation of a new mine to be charged off against income from that mine as quickly as desired. This change would take effect in 1974 at the expiration of the period for which the government in 1967 gave assurances that the three-year exemption would continue. The new rule would ensure that in the high-risk business of mining, taxes would not be paid until investments in new, projects are recovered, but it would do so on a more economical basis than the present exemption.	**Pages 53 to 56 of Brief** This portion of the brief states: 7:6 The development phase normally requires very large capital expenditures. A tax free period, perhaps limited as to amount, may still be desirable to increase cash flow in the early years of a mine and reduce the risk of new mine development. However, the fast write-off of assets appears to be a useful concept and should be an efficient and realistic economic mechanism, particularly in encouraging development of larger low grade ore bodies. 7:7 The White Paper proposals do not appear to take into account the impact of provincial mining taxes or competitive sources of minerals in countries such as Australia, where the tax climate is more advantageous than is contemplated by the present proposals. A minimum depletion may be necessary to take these into account.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies

Present Tax Law	White Paper Proposals	Principal Points of Brief
	1.52 The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Every $3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to $1 of depletion allowances if and when his production profits permit. Depletion allowances on new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system.	The concept of so-called earned depletion may also be a useful incentive but the ratio of 1 to 3 does not appear sufficient in itself. The depletion base in the case of mining companies appears far less adequate than that of oil companies. 7:8 The question of depletion and rate of tax generally is relevant to the exploratory effort, while the tax-free period affects the economics of bringing discoveries into production. Both are important, but in the long run, it is probably depletion which is more significant. 7:9 The withdrawal of depletion to shareholders of mining companies seems unfounded, because where the dividend is in fact a return of capital, capital losses under the White Paper proposals, will not provide the proper offset. 7:10 The incentive to prospectors and grubstakers should be retained but modified to be taxable at capital gains rates.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.25 The present rules concerning exploration and development costs accomplish the objective set out in the preceding paragraph: the costs of mineral exploration and development can be deducted for tax purposes early enough so that taxes will be applied only when it is clear that a project will be profitable. Under these rules, a corporation which has as its principal business either mining, the production of oil, or certain allied activities (refining and/or distributing petroleum or petroleum products, fabricating metals or operating pipelines), may deduct Canadian exploration and development costs as they are incurred. If these costs exceed the corporation's income, then it may deduct the balance of the costs in the first subsequent year in which it has enough income. 5.26 Other taxpayers may also deduct exploration and development costs as they are incurred, but if they do not meet the principal business test mentioned above, they may deduct them only from income from mineral properties. This rule has guaranteed that tax was not paid until these costs were recovered, but it has meant that taxpayers who were unsuccessful in their mineral projects have suffered losses that were not deductible for tax purposes. To cure this defect, it is proposed that taxpayers who fail to meet the principal business test be entitled to put their future exploration and development expenses in an asset class and to deduct annually part or all of their accumulated undeducted expenses up to a maximum of the greater of two amounts:	7:11 The whole concept of creditable tax destroys and immensely complicates the transfer of the benefit of depletion and similar incentives. It should be abandoned to provide tax free flow of dividends between corporations and uniform treatment of dividends in the hands of shareholders.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies

Present Tax Law	White Paper Proposals	Principal Points of Brief
	(1) their income from mineral properties before any deduction in respect of exploration and development expenses, or (2) 20 per cent of the net book value of the class. For this purpose, income from mineral properties would include producing profits, royalties received, and the proceeds of the sale of mineral rights. 5.27 Since 1962, the cost of acquiring oil rights or natural gas rights has been included in the definition of exploration and development expenses. Consequently these costs have been deductible for tax purposes within the limits of the rules relating to exploration and development expenses. It is proposed that this rule be retained, and that it be expanded to cover the costs of other mineral rights. 5.28 Also since 1962, the proceeds of sale of oil rights and natural gas rights have been treated as taxable income. As part of the proposal to tax capital gains, this rule would also be extended to apply to all mineral rights. A special rule would be applied to the proceeds of the sale of rights which are held on the day this White Paper is published if the proceeds of the sale of those rights would not have been income for tax purposes under the existing rules. This special, transitional rule is similar to that proposed in paragraph *5.8* with respect to existing goodwill; if the sale is in the first year of	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies

Present Tax Law	White Paper Proposals	Principal Points of Brief
	the new system, only 60 per cent of the proceeds would be taken into account; if in the second year, 65 per cent; the third year 70 per cent; and so on, increasing by 5 per cent each year until all of the proceeds are taken into income if the sale is in the ninth or a subsequent year. Since the cost of these rights would henceforth be deductible for tax purposes, prices should rise and this system should produce a fair after-tax return to the present owners.	
	New Mines	
	5.29 In addition to their exploration and development expenditures, mining corporations spend large sums of money on mining machinery and buildings before they know whether their new mine will be profitable. In order to recognize this risk, the government proposes to put depreciable assets of this type acquired for production from a particular new mine in a separate asset class and to permit the taxpayer to write them off for tax purposes just as fast as he has enough income from the new mine to absorb the charge. The assets concerned are those described in paragraphs (g) and (k) of class 10, which read as follows:	
	"(g) a building acquired for the purpose of gaining or producing income from a mine (except an office building that is not situated on the mine property and a refinery)	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	"(k) mining machinery and equipment acquired for the purpose of gaining or producing income from a mine." 5.30 This provision would not replace the existing right to deduct 30 per cent of the net book value of assets in this class: it would supplement it. If the new mine produces sufficient profit to absorb a deduction of more than 30 per cent, the taxpayer could make that deduction. If it does not, he could nevertheless deduct up to 30 per cent if he chooses, thereby either reducing other income or producing a business loss which could be offset against income in other years. 5.31 Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies

Present Tax Law	White Paper Proposals	[illegible]
	5.35 The present three year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits. 5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is 33⅓ per cent. Special rates of depletion are provided for gold and for coal.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: **Mining and Oil Companies**

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Mining and Oil Companies.

Present Tax Law

White Paper Proposals

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

Principal Points of Brief

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: International Income.

Present Tax Law

Section 28 - 1 of the Income Tax Act

This section permits a Canadian corporation owning more than 25% of the voting capital stock of foreign companies, to exclude from taxable income, dividends received from such companies.

The general provisions of the Income Tax Act require other foreign dividends received to be included in income.

White Paper Proposals

1.47 There would be some changes in the taxation of income earned by Canadian residents and corporations from sources outside Canada to prevent "tax havens" being used to evade Canadian taxes. Individuals would continue to pay Canadian taxes on investment and other income from sources outside Canada. They would receive a credit for the withholding tax or other income tax paid directly to governments of other countries. Corporations would also receive such credits except when income is from a controlled foreign corporation.

1.48 New distinctions between classes of foreign corporations controlled from Canada are outlined in Chapter 6 and will be further elaborated in supplementary papers. Unless tax treaties provide otherwise, Canadian corporations would be taxed on dividends received from foreign corporations in which they have a substantial interest. However, they would receive credit for the withholding taxes levied on the dividend by the foreign country, and for the corporation tax paid by the foreign corporation on the profits from which the dividend was paid. Tax treaties would maintain the exemptions for dividends received from foreign corporations more than 25-per-cent-owned by the recipient Canadian corporation, and carrying on bona fide active business operations in the foreign country. Other provisions patterned generally on the United States law would impose full Canadian

Principal Points of Brief

Pages 57 to 59 of Brief

This portion of the brief contains the following statements:

8:1 It is a generally recognized principle of taxation that gains of foreigners derived from a country are only taxable in that country if they are attributable to a permanent establishment. It seems incredible that Canadians who have one of the most open economies in the world for capital and trade should expect the world to turn recognized practice upside down.

8:2 It also seems extremely inconsistent to attempt to tax our own citizens upon gains realized on assets held abroad and to tax gains of foreigners realized on assets held here.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: International Income.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	taxes on corporate income accruing in "tax-haven" operations. Various other detailed safeguards would be introduced to keep to a minimum the use of non-resident corporations to reduce Canadian taxes of Canadian residents. 6.11 The system by which the government proposes to attain its objectives is set out in the following paragraphs. These paragraphs deal successively with dividends from controlled foreign corporations, passive income of controlled foreign corporations, other foreign investment income, business profits and salaries and wages earned abroad by Canadians, and a new procedure for giving shareholders of Canadian corporations credit for the foreign withholding taxes paid by their corporations. 6.15 The government has concluded that neither of these systems is either "right" or "wrong". It proposes to continue in a restricted form the present exemption of dividends received by a Canadian corporation from a controlled foreign corporation. For this purpose, the Canadian corporation would be assumed to control the foreign corporation if it owns 25 per cent or more of the voting shares of the foreign corporation. The first restriction proposed is that the exemption privilege would be extended only to dividends from those countries with which we have concluded bilateral tax treaties. A second is that the effect of the exemption would be eliminated for certain types	8:3 The attempt to tax substantial investment of foreigners is likely to be counter-productive firstly because it will discourage foreign investment and secondly, because the foreigner can easily take steps to avoid the tax through the use of holding companies. It seems a strange reward for those foreign investors who answered the "Degree of Canadian Ownership" appeal. 8:5 The discrimination against venture abroad by Canadian enterprise is also shortsighted. There are areas such as mining, oil exploration, and other key industries where Canadians have accumulated skill, technology and capital. We should encourage the exercise of our skills to the benefit of opportunities for Canadians income for Canadians, and benefits to the foreign country.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: INTERNATIONAL INCOME

Present Tax Law	White Paper Proposals	Principal Points of Brief
	of diverted income by the proposals described below under the heading "Passive Income of Controlled Foreign Corporations." These restrictions are necessary to frustrate efforts to use the dividend exemption to reduce artificially the tax burden on tax-haven income.	8:8 The proposal to increase withholding tax rates seems to assume that this will pressure other countries to agree to our type of tax treaty. Since we are substantial importers of capital, and likely to remain so, the more likely effect will be to increase the cost of imported capital to cover the additional cost of withholding tax.
	6.17 A dividend from a Canadian-controlled foreign corporation not protected by tax treaty would be subject to a tax-credit regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underlying business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available.	8:9 The White Paper proposes to remove dividend tax credit provisions as they apply to foreign companies resident in Canada. No justification is given. Companies incorporated in certain countries cannot re-incorporate because of punitive tax consequences abroad.
	6.18 The existing dividend exemption system would be retained for several years, at least through 1973, as a transitional measure until an appropriate network of international tax treaties can be built up.	8:10 The White Paper does not establish that there are any abuses in the international area which require, or are capable of, correction by their recommendations. These proposals should be dropped.

JAMES RICHARDSON & SONS LIMITED

Principal Subject: International Income.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.19 Subject to the limitation noted below, the general capital gains provisions would apply to the shares of controlled foreign corporations—gains realized on the disposal of them would be fully taxable and losses fully deductible (except of course to the extent that the gain or loss accrue prior to valuation day). However, because full corporate tax would not be collected on dividends from such corporations it would be necessary to place a limit on the deductibility of losses if the system as a whole is to be effective. Otherwise, Canadian corporations could purchase control of foreign corporations, arrange to receive most of the assets of the company as a special dividend, and then sell the shares for the value of the remaining assets. The dividend would bear little or no Canadian tax because of the foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax. This tax result is clearly inappropriate since the Canadian corporation would not, in fact, have suffered an over-all loss on its investment. To avoid this consequence, it is proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation tax.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: International INcome

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.20 As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely. 6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: International Income.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.22 At present, a Canadian individual who receives foreign investment income, and a Canadian corporation that receives foreign investment income other than a dividend from a controlled foreign corporation, include the investment income in taxable income and can deduct from the Canadian tax on that income the foreign income taxes he has paid to the government of the foreign country. The government proposes to continue this treatment substantially unchanged. However it believes that in normal circumstances the rate of withholding tax levied on portfolio investment income flowing between countries that have a tax treaty should not exceed 15 per cent. For its part, Canada will be willing to limit its withholding tax on such income to 15 per cent. To achieve balance, it is proposed that the maximum rate of tax for which foreign tax credit would be granted on this type of income be 15 per cent. To provide time for Canada to expand its tax-treaty network, and for taxpayers to rearrange their investments, this rule would not go into effect until 1974.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: International Income

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.23 The present tax treatment of the business profits and wages earned abroad by Canadian corporations or individuals is the same as that for portfolio investment income. The income is taxed as earned, and the taxpayer is entitled to a foreign tax credit for taxes paid to the government of the foreign country on that income. The government proposes to continue that treatment. 6.24 While the government proposes to retain the existing system of taxing foreign business profits, two important changes to the foreign tax-credit provisions are appropriate. Provisions will be put forward to prevent taxpayers from reducing Canadian tax by transferring the operation of a foreign branch which has sustained losses to a foreign company in order to avoid the Canadian tax which should ordinarily be recaptured on subsequent branch profits. 6.25 In addition, the government proposes to amend the foreign tax-credit provisions to permit the excess of foreign taxes paid over the amount creditable in a year to qualify for allowance in other years. The carry-over of the foreign tax credit is intended to alleviate the problem that arises when income is taxable abroad in a different year from that in which it is taxable in Canada.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: International Income

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.26 In its tax treaties, Canada will also be prepared to recognize the income taxes levied by political subdivisions of foreign countries on a reciprocal basis. If the foreign country is prepared to give a foreign tax credit for the income taxes levied by the provinces, Canada will agree to give a credit or a deduction, whichever is appropriate, for the taxes levied by its political subdivisions.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Provincial Taxation

Present Tax Law

Sections 33-1 and 40 of the Income Tax Act.

These sections provide for a deduction from the tax payable for income earned in a province.

White Paper Proposals

2.33 The federal government wishes to avoid causing any significant change in provincial revenues through its changes in exemptions and rates. But the present complicated system must be improved. Accordingly, it is proposed to meld the basic rate schedule, the old age security tax, the social development tax, the current surtax and the 20-per-cent reduction into one new schedule of graduated rates which, when used with the increased exemptions, would produce about the same revenue as the aggregate of the present basic tax after abatement and the other taxes on income. The provincial abatement of 28 per cent would be eliminated and the provincial tax would be calculated as a percentage of the whole federal tax. To illustrate:

present calculation

$100 basic tax is abated by 28 per cent to	$ 72	
old age security tax, social development tax, 20 per cent reduction and surtax aggregate approximately	28	
total federal tax	$100	
provincial tax at 28 per cent of basic tax		$28

Principal Points of Brief

Pages 60 to 62 of the brief

This portion of the brief states:

9:1 The effect of the tax changes if fully implemented on the basis of 1969 incomes appears to be a substantial increase in tax. If the provinces fit within the overall structure, as contemplated by Chapter 2 of the White Paper, they would not receive less revenue than at present, but they do not share significantly in the increase.

9:2 The change in calculation effectively reduced the provinces' abatement from 28% to about 22% - that is, the federal share of the "ideal" personal tax burden becomes 78% instead of 72%. Since the provinces are no worse off in revenue terms, this means that the bulk of the increase in tax accrues to the federal government. The provinces are kept in the same current position by including within their participation specific taxes at the lower and most broadly based levels.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Provincial Taxation

Present Tax Law	White Paper Proposals	Principal Points of Brief
	new calculation federal tax using new exemptions and rate schedule $100 provincial tax at 28 per cent of federal tax $28 2.34 Under this new system federal tax would be abated by an additional 22 per cent for taxpayers in Quebec as part payment to the province for shared programs so their position would be unaltered. An adjustment would also be necessary for taxpayers not resident in any province. These include taxpayers in the territories and government employees living outside Canada but deemed to be residents of Canada for tax purposes. At present these taxpayers receive no provincial abatement because they are not subject to a provincial tax. Under the new proposal they would pay tax under the same new rate schedule as taxpayers in the provinces but be charged an additional tax to correspond to the provincial tax.	9:3 While the rate schedule has become more progressive upon the middle class the provinces' percentage share of increasing revenues will decline while the revenue accruing to the federal government will accelerate. 9:4 The proposals would reduce the provinces' personal tax base by increasing personal exemptions, reducing the percentage share of increasing income and retaining the increase in tax revenues from the corporate sector for the federal level. As a result the surtaxes upon income which they are likely to impose will have to be exaggerated to raise the required revenue. 9:5 The requirement that provincial tax be a fraction of federal tax accelerates the progression of the rate structure in the event that the provinces tax at above the expected level. 9:6 For example, if the expected level of provincial is 20% and turns out to be say 50%, the take home income of the 20% federal

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Provincial Taxation

Present Tax Law	White Paper Proposals	Principal Points of Brief
	7.8 At present the general abatement of the basic federal income tax on individuals, to make room for provincial tax, is 28 per cent. Under the tax collection agreements the provinces define their tax, in effect, as a percentage of the applicable federal tax. The provinces of British Columbia, Ontario, Prince Edward Island and Nova Scotia have entered into collection agreements and use the same 28-per-cent figure to define their tax. Commencing January 1, 1970, the rate in Newfoundland, Saskatchewan and Alberta will be 33 per cent; in New Brunswick, it will be 38 per cent; and in Manitoba, 39 per cent. Quebec collects its own tax at graduated rates equal to 50 per cent of the federal graduated rates and with exemptions similar to those of the federal system, except for the absence of deductions for children eligible for family allowances and different starting points in basic personal exemptions. The Quebec tax rates are higher than those of the other provinces because of the higher federal abatement for provincial tax in that province (50 per cent instead of 28 per cent). In 1968 and 1969, Quebec tax liability is increased by the imposition of a temporary 6-per-cent surtax. 7.9 The abatement of the federal corporation tax to make room for provincial tax is 10 per cent of taxable income. All provinces except Ontario	taxpayer is reduced at the margin by about 8%, for the 40% federal taxpayer, his take home pay at the margin is reduced 23%. This example may be exaggerated but the present 11% surcharge in Manitoba operates as a 2.2% tax on income at the 20% rate, 5.5% at the 50%, and at about 8.9% at the highest basic rate of just over 80%.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Provincial Taxation

Present Tax Law	White Paper Proposals	Principal Points of Brief
	and Quebec have entered collection agreements for this tax. Ontario and Quebec collect their own corporation income taxes but largely follow federal rules to determine taxable income and allocate it among the provinces. Commencing January 1, 1970, the provincial rates of corporation income tax will be: Newfoundland and Manitoba, 13 per cent; Ontario and Quebec, 12 per cent; Saskatchewan and Alberta, 11 per cent; and the other four provinces, 10 per cent. 7.14 An abatement of the federal income tax would also be required in order to continue the necessary adjustments with the Province of Quebec by which special reductions in federal taxes in that province would also continue to be made. These reductions are a partial payment for the federal share of the cost of certain joint programs such as hospital insurance and welfare assistance. It would be expected that Quebec would maintain its correspondingly higher provincial tax in order to secure the revenues it requires for these programs. The province would not, of course, need in any way to increase its existing rates in order to retain its present revenues. Abatements could also be used to provide corresponding treatment where other provincial governments take up a federal offer to meet all or part of the federal share of the costs of joint programs in this way. If all provinces entered into such arrangements, an adjustment of the basic rates could replace these abatements.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Provincial Taxation

Present Tax Law	White Paper Proposals	Principal Points of Brief
	7.24 The government suggests that the provincial laws should provide for taxing the income of Canadian shareholders of Canadian companies on a basis consistent with the new federal law. Assuming that the proposals in this paper are adopted, this would mean using the system of corporate tax credits instead of the dividend tax credit already used by the provinces as well as by Canada. The provinces would tax the same amount as the federal law but give credit only for a standard 10-per-cent rate of provincial tax. With closely-held companies, a full credit would be given for an assumed provincial corporate tax of 10 per cent; with widely-held companies, credit would be given for an assumed provincial tax of 5 per cent. These credits would require appropriate changes in provincial legislation.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Farmers

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 42 of the Income Tax Act: This section permits a farmer to average his income.	2.57 It is not proposed to remove the present averaging formula for farmers or fishermen who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.	Page 63 of the brief This portion of the brief states: 10:1 Due to the current depressed markets for grain, land values in Western Canada have suffered a decline. As this situation may prevail at the time values are established for capital gains purposes, we recommend that gains be taxed only from the cost or value on valuation day whichever is higher. 10:2 While we have recommended that the tax on capital gains on principal residences be eliminated, we recognize that this approach is not suitable when applied to the sale of a farm with farmhouse that has been a principal residence. We therefore support the proposal of a per annum exemption for farms which are principal residences as provided in the White Paper. 10:3 We emphasize in the farming area our general recommendations with respect to capital gains and that estate taxes should be reduced so that the total capital gain and estate tax would not exceed the present burden.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Farmers

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.48 Farmers are also at present entitled to compute their income on a cash basis. The government has given serious consideration to this provision and has concluded that it should remain. As regards market farmers, their inventories are so perishable that year-end inventories are not significant. Under present marketing arrangements, grain farmers are not permitted to sell their own inventories and it would be unfair to require them to pay tax on an amount that they could not take steps to realize. This leaves livestock farmers. 5.49 Livestock farmers have been able to treat part of their herds as a capital investment. The cost of acquiring or raising these animals is a non-deductible capital expenditure and the proceeds of their sale gives rise to a non-taxable capital gain. Under the government's proposals capital gains would in future be taxable so that this "basic herd" concept would be obsolete. It is not thought appropriate to add a change to accrual accounting on top of this "basic herd" change. 5.50 The government does not propose to tax capital gains that accrue before the new system begins. Consequently the fair market value of a farmer's basic herd at the beginning of the new system would be tax-exempt. His basic herd would be treated as an inventory of animals that he purchased at their fair market value at the commencement of the system.	

Name: James Richardson & Sons Ltd.,

Principal Subject: Farmers

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.51 Farmers and fishermen are now entitled to avoid the recapture of depreciation on the sale of their depreciable assets if they claim depreciation on what is called the straight-line system—computed at rates generally one-half of those used under the asset-class system. Any profit on the sale of such a depreciable asset is considered a capital gain. Once capital gains are taxable, the advantages of the straight-line system disappear and farmers and fishermen would find it advantageous to use the asset-class system because (1) of the more generous rates, and (2) profits on the sale of assets reduce the base for subsequent depreciation rather than bearing tax immediately. Naturally, the proceeds of the sale of assets owned on the day the system starts would continue to be tax-free to the extent that they represent a capital gain accrued to that date—that is, the fair market value exceeds the net book value of asset on commencement day and the taxpayer is able to realize that excess.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Goodwill

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not consider goodwill to be a depreciable asset.	5.4 There is a class of expenditure incurred by businesses that is not deductible, either in the year in which the expenditure is incurred or over a series of years. The taxpayer is prohibited from deducting them in the year in which they are incurred because they are capital expenditures. He is prohibited from deducting the cost over a number of years by way of depreciation because they do not give rise to an asset for which provision is made in the depreciation regulations. Perhaps the best known of these capital nothings is goodwill. If a Canadian buys a business, he can neither deduct nor depreciate the portion of his purchase price that relates to the goodwill of the business. 5.5 The government proposes to create a new depreciation class which would sweep up all of these nothings and which would enable the taxpayer to deduct 10 per cent of the book value of this class each year. We believe that the 10-per-cent rate is fair if one takes into account the type of expenditure to be included.	Pages 63 to 64 of the brief This portion of the brief states: 10:4 We believe the proposals in respect to goodwill are arbitrary and could prove to be unfair in certain circumstances. We recommend goodwill be treated as follows: (a) As a depreciable asset where the cost of the asset could be claimed as expense over ten years on a straight line basis and any recapture on sale to be classified as income. (b) Any proceeds on the sale of goodwill in excess of original cost be taxed as capital gains. (c) The fair market value of any goodwill at valuation day would not be subject to tax in the event of sale except to the extent it has been deducted against taxable income.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Goodwill

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.6 This proposal would be impossible without a tax on capital gains. For as long as the proceeds of the sale of goodwill, among other things, remained tax-free, it was impossible to give a deduction for the cost of purchasing goodwill without creating a leak in the tax system. This leak would cost significant amounts of revenue even under ordinary commercial practices, and the revenue loss would be greatly increased as a result of taxpayers arranging their affairs to take maximum advantage of the situation. 5.8 Another fact must be taken into account in setting the treatment of early sales of goodwill: purchasers would be willing to pay more for goodwill under the proposed system (since they can deduct the expenditure for tax purposes over a period of years) than they are willing to pay under the existing system. With these factors in mind, the government proposes that taxpayers who sell goodwill in the first year of the new system would be taxable on 40 per cent of the proceeds and exempt on 60 per cent; if in the second year, taxable on 45 per cent and exempt on 55 per cent; and so on, with the taxable portion increasing by 5 percentage points each year until the thirteenth year when 100 per cent of any proceeds would be taxable. Naturally, if a sale of goodwill involves a business that was not in existence when the new system commences, all of the proceeds would be taxable even though the sale takes place before 12 years have passed.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Capital Cost Allowances on Rental Real Estate

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not limit the capital cost allowances that may be claimed on rental real estate.	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	Pages 64 and 65 of Brief This portion of the Brief states: 10:6 The combined effect of the above proposals is to discriminate against investment in rental property as compared to investment in any other form. The owner of an investment property may, because of economic conditions at a particular time or through other factors, suffer a substantial loss on the holding of a real estate property, and we see no reason why actual costs incurred to produce taxable income should not be deductible. 10:7 The result of implementing discriminatory provisions of this nature would seem to be that apartments and other rental property would become more expensive to rent and the amount of construction would be reduced as investors look for other forms of investment. This comes at a time when Canada is encountering a very high rate of family formation and there is a great social need for more housing.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Capital Cost Allowances on Rental Real Estate

Present Tax Law	White Paper Proposals	Principal Points of Brief
		10:8 If there is a problem in the present tax structure, it arises from the method of determining income and any changes should be made in this area and not through arbitrary exclusion of expenses. 10:9 In the capital gains section of this submission, we recommend that all capital gains be deemed to be realized at death. Based upon this recommendation, any unrealized gain in real estate at the date of death would be subject to capital gains tax and the beneficiary would then take over the asset at fair market value and depreciate on that basis.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Trusts

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act treats trusts as a conduit and taxes the beneficiaries on distributions made to them. Only if income is retained by the trustee does the trust itself become subject to tax.	2.47 The government believes it desirable to encourage these personal savings plans for retirement. But it must be done on an equitable basis, available to all and subject to fair and reasonable limits. The government also believes that the tax-free trusts for retirement plans should not be entitled to the credit for corporation income tax proposed for dividends on shares in Canadian corporations. Freedom from tax on dividends and interest and capital gains should be sufficient. 5.55 Under the present tax system, all taxable trusts are subject to the same set of rules, the most important of which are as follows: (1) generally income received which is payable to beneficiaries in the year received is taxable to the beneficiary not the trust, (2) income that is not so payable is taxable to the trust, and for this purpose the trust uses the personal rate schedule (although it is not entitled to a personal exemption), and (3) once the trust has paid income tax on an amount, the balance can usually be distributed in subsequent years without further tax.	Page 65 and 66 of Brief This portion of the Brief states: 10:10 The White Paper proposes that trusts be taxed in future at the corporate rate rather than being taxed at the individual income tax rates as in the past. In many cases trusts have been established either by inter vivos gift or by will under which the terms of the trust cannot be changed. Any drastic change in the basis of taxing these trusts, would place an unfair tax penalty upon the ultimate beneficiaries of the trusts. 10:11 If there are particular abuses, we believe they should be covered specifically rather than being covered by a change in the overall taxing philosophy.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Trusts

[illegible]	White Paper Proposals	Principal Poin[illegible]
	5.56 Because a trust is not taxed on income which is payable to its beneficiaries during the year, many trusts do not pay any tax at all. Some of these trusts are in direct competition with widely-held public corporations and have as many beneficiaries (in this case usually unit holders) as some public corporations have shareholders. The tax rules give these trusts an advantage over their competitors. It is proposed that a trust be treated as a corporation if it has issued transferrable or redeemable units, each of which represents a specific undivided interest in the trust property. If the number of unit holders and marketability of the units warrant it, the trust would be treated as a widely-held corporation. If such a trust were a mutual fund, it would be taxed in the same manner as an incorporated mutual fund.	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Trusts

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.57 The fact that a trust is entitled to use the personal rate schedule in computing its tax means that income accumulated in a trust may bear significantly less tax than if the income were taxable to the beneficiaries, and the tax saving is not offset by a further tax when the funds are eventually distributed. (The number of accumulating trusts has increased significantly during the past few years.) If a trust is covered by the proposal set out in the preceding paragraph, this loophole would no longer be available. To close it for other trusts, it is proposed that income accumulating in such trusts be subject to a flat-rate federal tax of 40 per cent; provincial taxes would increase this rate to the neighborhood of 50 per cent and the corporate rate. A special relieving provision would reduce the	

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Cash or accrural basis of Computing Income

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act permits taxpayers who practice a profession or who are farmers or fishermen may compute income on a cash or accrual basis.	5.46 Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.	10:12 The Income Tax Act presently permits taxpayers in the professions to follow a cash basis of accounting, and the White Paper suggests that this gives this class of taxpayer an unwarranted advantage by comparison to the rest of Canadians. 10:13 We believe that the proper comparison of taxpayers in the professions is with professional individuals who are employed by business, or indeed other employees. 10:14 We believe that taxpayers in the professions should be entitled to continue using the cash basis.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Entertainment and related expenses

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act permits the deduction from income of reasonable amounts of business promotion expenses.	1.35 Various fringe benefits received by employees or by the owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yachts and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer. 5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	Pages 66 and 67 of Brief This portion of the brief states; 10:15 It is proposed in the White Paper that no deduction be allowed for entertainment expenses, the cost of attending or sending employees to conventions and the cost of dues for membership in social or recreational clubs. We do not believe that deduction should be denied to any genuine business expense which has been laid out for the purpose of earning income.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Pension Plans

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 62-1-q of the Income Tax Act This section exempts from tax the income of a pension trust or corporation that meets specified requirements.	2.47 The government believes it desirable to encourage these personal savings plans for retirement. But it must be done on an equitable basis, available to all and subject to fair and reasonable limits. The government also believes that the tax-free trusts for retirement plans should not be entitled to the credit for corporation income tax proposed for dividends on shares in Canadian corporations. Freedom from tax on dividends and interest and capital gains should be sufficient. 2.51 Most pension funds now are subject to regulation under the Pension Benefits Standards Acts of the provinces or of Canada. These control the investments of pension funds in a manner generally adequate for tax purposes. However, it is essential to be sure that tax-free funds cannot be diverted through investment in such a way as to bring current benefits to those who contribute to them and control them, and to provide sanctions to be applied when investments are made contrary to the rules. With adjustment to meet these two points it is proposed that the rules applying to invesment of pension funds be the same as under the provincial and federal laws respecting pension plans. For registered retirement savings plans the permitted range of investments could be somewhat broader.	Pages 67 and 68 of Brief This portion of the Brief states: 10:16 The White Paper proposes that at least 90% of the assets of pension plans and retirement savings plans be invested in Canadian securities. 10:17 There are many sectors of industry which are not represented by Canadian securities. For pension fund or retirement fund trustees to maintain a balanced portfolio they should have the flexibility of being able to invest in foreign securities. Foreign holdings will not usually be large because the withholding tax provides a bias towards Canadian securities. Further incentive should be unnecessary. 10:18 If the proposals were adopted, trustees representing millions of Canadians would be prevented from taking steps to protect the assets of their funds at times when the Canadian market was dropping.

Name: JAMES RICHARDSON & SONS LIMITED

Principal Subject: Pension Plans

Present Tax Law	White Paper Proposals	Principal Points of Brief
	2.52 Three other changes are also proposed. First, the savings withdrawn from these plans would be taxed at ordinary rates, even if the amounts are withdrawn at the death of the contributor. A widow would be permitted to offset or reduce this income if she contributes all or part of the proceeds to a registered retirement savings plan of her own. Second, rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets. Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other foreign investments. 4.60 The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities.	Furthermore, by locking these assets into Canadian securities a stabilizing factor would be removed from the market place. 10:19 The White Paper proposes pensions paid from Canada to persons living outside would be subject to a withholding tax of 25% with provision for higher or lower rates. 10:20 We oppose the deduction of a withholding tax which may further affect a retired person's standard of living which, in most instances, is reduced on retirement. This income is normally fixed for life subject to a further decline in the standard of living through inflation. 10:21 We recommend that both proposals be abandoned.

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 23

WEDNESDAY, MAY 13, 1970

Seventeenth Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 23:5)

APPENDICES:

"A"—Brief from the Canadian Retail Hardware Association.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from Noiseux, Lyonnais, Gascon, Bedard, Lussier, Senecal & Associés.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from Edmund H. Peachey Limited.
"F"—Brief from the Canadian Art Museums Directors' Organization.
"G"—Brief from The Montreal Museum of Fine Arts.
"H"—Analysis of Appendix "G" by Senior Advisor.

22007—1

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate,

22007—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, May 13, 1970.
(33)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Salter A. Hayden (*Chairman*), Aird, Aseltine, Beaubien, Benidickson, Blois, Carter, Connolly (*Ottawa West*), Desruisseaux, Flynn, Everett, Giguere, Haig, Hollett, Isnor, Kinley, Macnaughton, Molson, Phillips (*Rigaud*) and Welch—(20).

Present, but not of the Committee: The Honourable Senators Laird and Urquhart—(2).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

Canadian Retail Hardware Association.

Mr. A. G. Lochead, President;
Mr. J. T. Valiant, Past President;
Mr. T. M. Ross, Executive Director.

Noiseux, Lyonnais, Gascon, Bedard, Lussier, Senecal & Associés.

Mr. Paul Noiseux, C.A.;
Mr. Lionel Gascon, C.A.;
Mr. Pierre Bedard, LL.L., C.A.

Edmund H. Peachey.

Mr. E. H. Peachey, President.
(Edmund H. Peachey Ltd.,)
(Peachey Homes (Peel) Ltd.,)
(Valhalla Inn Ltd.,)
(Bloor Lea Investments Ltd.)

Canadian Art Museums Directors' Organization.

Mr. David G. Carter, President.

At 12:40 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(34)

At 2:15 p.m. the Committee *resumed.*

Present: The Honourable Senators Salter A. Hayden (*Chairman*), Aird, Aseltine, Beaubien, Benidickson, Blois, Carter, Desruisseaux, Everett, Giguere, Haig, Isnor, Kinley, Macnaughton, Molson, Welch and Willis—(17).

Present, but not of the Committee: The Honourable Senator Laird—(1).

In attendance: Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

WITNESSES:

Montreal Museum of Fine Arts.

Dr. Sean Murphy, President;

Mr. David G. Carter, Director;

Mr. Charles Gonthier, Honorary Secretary.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from the Canadian Retail Hardware Association.

B—Analysis of Appendix "A" by Senior Advisor.

C—Brief from Noiseux, Lyonnais, Gascon, Bedard, Lussier, Senecal & Associés.

D—Analysis of Appendix "C" by Senior Advisor.

E—Brief from Edmund H. Peachey Limited.

F—Brief from the Canadian Art Museums Directors' Organization.

G—Brief from The Montreal Museum of Fine Arts.

H—Analysis of Appendix "G" by Senior Advisor.

At 3:10 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, May 13, 1970

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I call the meeting to order. We have five submissions today. The first one is the Canadian Retail Hardware Association. Mr. Ross, the Executive Director of that association, is sitting on my immediate right. He is going to lead the presentation. With him is Mr. Lochead and Mr. Valiant, who are part of the panel. Mr. Ross knows how we proceed—that if there are any matters he wants to refer to them he may do so.

Now, Mr. Cross, would you care to open the proceedings and tell us in a summary way what your presentation is?

Mr. T. M. Ross, Executive Director, Canadian Retail Hardware Association: Thank you, Mr. Chairman. Mr. Chairman and distinguished members of this committee, as the Chairman has already stated, the brief which is before you is submitted on behalf of the Canadian Retail Hardware Association. My name, as the Chairman has so kindly announced, is Tom Ross. I am the chief salaried officer of the association. The gentlemen who accompany me this morning have the distinction of having been elected to executive posts of the association by their confrères. Mr. Lockhead, on my immediate right, is the current President of the association. He is a practising hardware retailer from the town of Forest, Ontario. On my extreme right is Mr. Jack Valiant, the Immediate Past President of the association, who is a practising hardware retailer from the city of Toronto.

We are aware, Mr. Chairman and honourable senators, that you have received a great volume of advice concerning the White Paper and in order to refresh your memories as to the position taken by our brief perhaps I should read to you the summary of recommendations which begins on page 44 of our printed document.

Would that procedure be acceptable, sir?

The Chairman: Certainly. Go right ahead.

Mr. Ross: The summary of recommendations is as follows:

> The Canadian Retail Hardware Association begs to present the following recommendations in respect to the proposals contained in the White Paper on Tax Reform:
>
> That the government abandon thoughts of dramatic change of a tax system that has served the country remarkably well, and proceed with orderly and cautious tax reform in order to preserve the stability of the economy and the balances within it while gradually serving the needs of the day.
>
> That the proposal to eliminate the present two-tiered system of corporate taxation be abandoned and that a preferential corporate tax rate on the first $35,000.00 of corporate profits be retained as essential to the growth, incentive, viability and competitive position of small, relatively high-risk businesses.
>
> That the categorization of corporations for tax purposes as closely-held and widely-held, regardless of scale or level of profits, be abandoned as regressive, and that the present progressive categorization based on level of corporate profits be maintained.
>
> That accelerated capital-cost allowances for small businesses be considered and implemented as a needed stimulus to small business expansion.
>
> That the rate of taxation applied to capital gains be substantially lower than the personal marginal tax rate in recognition of the fact that, to some extent, it is a tax on inflated values.

That capital gains tax be not applied to surpluses of small businesses on their sale in recognition that the surplus is generated from tax-paid profits.

That if the preferred tax rate on the first $35,000.00 of corporate profits is removed, owners of small businesses be allowed to gain tax relief for monies left in the business in much the same manner as deposits in registered retirement savings plans are exempt from tax, in recognition of the fact that the business is often the sole source of retirement capital for small businessmen.

That capital gains tax not be applied on the sale of a business within a family if the original owner is forced to leave Canada for valid medical reasons.

That transfers of family businesses between generations be eased by the provision of low-cost government loans to allow the second generation to cover estate or gift tax without resorting to sale of the business.

That the proposal to disallow the cost of attendance at Conventions and Seminars as a legitimate expense of a business before tax be abandoned and the privilege of deducting such items from personal taxable income be allowed for employees in recognition that such expenses contribute to the knowledge and expertise of both the owner of a business and his employees.

That the proposal to impose a minimum stand-by charge on all businessmen who have minimal access to use of a company vehicle be abandoned in favour of individual rulings in each case in order to prevent penalizing those who use the vehicle other than by their own choice.

That the proposals to remove certain of the tax advantages enjoyed by co-operatives be extended to remove all advantages in recognition that co-operatives serve the same markets and compete directly with other types of business organizations.

That the proposal to tax investment income of associations and other non-profit groups while exempting labour unions and religious organizations be abandoned, but failing this, be applied equally to all non-profit organizations.

That the government seek more meaningful dialogue on tax reform through its introduction in easily understandable units rather than the introduction of a complicated set of inter-dependent proposals toward which even tax experts cannot find general agreement.

That the government assure the people of Canada of some stability in tax structure within which businessmen and individuals may confidently plan necessary or desired long-term commitments in recognition of the fact that turmoil in the tax structure causes severe hardships for those who have entered such agreements.

That the government clearly and concisely outline its need for an ever-increasing proportion of the Gross National Product of Canada whenever tax increases are proposed or implemented.

The Chairman: Mr. Ross, I was wondering whether you could at this stage tell us for the record something about your organization and its membership. I know it is in your brief, but could you say a few words about the range of your membership?

Mr. Ross: Yes, senator. The Canadian Retail Hardware Association is a voluntary organization comprised of approximately 1,400 members from coast to coast in Canada. The typical member, if any member can be called typical, is a ruggedly independent businessman on a relatively small or small-to-medium scale. All the businesses which comprise the Canadian Retail Hardware Association are wholly or almost wholly Canadian-owned. Our membership displays a great deal of interest in such things as tax laws and also in such things as the effect of tax laws on the Canadian economy.

Senator Phillips (Rigaud): Can you tell us how your 1,400 members are divided from the point of view of being corporations, individuals or partnerships?

Mr. Ross: I cannot tell you that.

Senator Phillips (Rigaud): Even roughly speaking?

Mr. Ross: Well, roughly speaking I would expect that perhaps two-thirds of our members, and this is a rough guess, would be incorporated.

Senator Carter: Mr. Chairman, the brief implies that most of these hardware enterprises are small businesses. I wonder if Mr. Ross can give the committee some idea as to

what standards are used to measure the size of the business. Would you clarify the term "small business" as being decided by gross turnover, gross sales or by profits? What yardstick do you use to measure a small business? And then, to what extent do the hardware enterprises come into that classification?

Mr. Ross: This is a very difficult question, senator. We have never established a top limit for a small business, so to speak. Therefore there is no strict definition. However, we do carry out a survey of hardware operations every year. Our latest survey is bound into the brief at the back and there you will see that the average sales of members who replied to the survey amounted to $166,000 yearly. These sales supported a net profit of about $5,500 after the owner's withdrawals for salary and this kind of thing. So we have assumed that this would be a very small-to-medium sized enterprise.

Senator Molson: Could I ask a supplementary question? In the table in this appendix what is that appendix marked B? Is it a financial survey?

Mr. Ross: It is appendix B.

Senator Molson: It is the 1968 financial survey of the Association. You have statistics from 190 reporting stores and you say the average sales are $166,000. I notice here that 80 stores in Ontario represent the smallest gross sales out of the total sales and that rather surprises me. Is there anything in the pattern of the survey that would give rise to that? The average for the whole Province of Ontario surely would not be lower than anywhere else, would it?

Mr. Ross: I think it is pretty well generally true that Ontario is in the lower range, mainly because our members who are typically hardware retailers from the Prairies are frequently also involved in furniture, white goods, refrigerators, stoves and this kind of thing and so they have a larger volume. It may not be particularly a larger gross margin, because these might be very narrow marginal items, but at least they are involved in many more things than our members in Ontario whom we regard as typical hardware retailers.

Senator Molson: You say the net profit from these sales is as represented, $5,500 on the average. But on the lower line you have "Proprietor's Total Return" averaging at $15,800. That would exclude his salary and any benefit he can or does extract from the business, whatever form that might take. That would be his total benefit from these operations?

Mr. Ross: That is correct, senator. It is a combination of net profit, and up earlier in the expense column you will see "Proprietor's Drawings or Manager's Salary", $8,671 plus $5,511 and then other income at $1,638 so that is the total amount of money before tax that the owner is taking out of the business.

Senator Laird: Would that include members of his family who might be on salary?

Mr. Ross: Not necessarily.

Senator Carter: Can you tell us to what extent or what proportion of the businesses are family-owned?

Mr. Ross: Again, senator, I would be guessing. But I am sure one of the gentlemen with me could answer that.

Senator Carter: Would it be more than 50 per cent?

Mr. Ross: I would think it would be considerably more than 50 per cent. There is very little corporate retailing in the strict hardware sense.

Senator Benidickson: Do franchise hardware stores qualify for membership in your organization?

Mr. Ross: They do, senator. Most of the franchise groups in Canada are a loose coalition of independent dealers who, for one reason or another, subscribe to one of the franchise programs which gives them certain merchandise which they might not have had access to otherwise and promotional planning and this kind of thing.

Mr. J. T. Valiant, Past-President, Canadian Retail Hardware Association: I would say family ownership would range in the 70 per cent region. There is a highly preponderant element of family ownership.

Senator Molson: What would be the average number, if there is such a figure, of employees in the 1,400-member stores?

Mr. Ross: I must apologize, senator, that I am not great at remembering figures, but I think we have it in our brief somewhere. The average store employs an average of five persons, so that we have estimated that our membership totally employs 6,900 people for our 1,400 stores.

The Chairman: This presents some problems, Mr. Ross, in trying to arrive at a working formula to determine what is a small business. It is obvious that a business that has sales of under $200,000 and has a net profit of $5,000 or $6,000 is certainly a small or a smaller business. Where would the range be the other way? To what extent could that increase and still be classified as a small business, in your opinion?

Mr. Ross: Mr. Chairman, I would hate you to think I believe everything in the White Paper to be bad—I do not, by a long shot; but I think that the present taxation system has a very good measure of the size of the business in the split corporate tax rate, in that on the first $35,000 of profit it is considered, traditionally, under our present tax system, as a small business profit.

Senator Benidickson: That is corporate profit after paying salaries, probably to the principal shareholder?

Mr. Ross: That is correct, sir. That might be high; I do not know.

The Chairman: We have had indications it might be low, that in a small business the net profit might run to $60,000 or $75,000 a year.

Mr. Ross: One of the critical differences, of course, Mr. Chairman, if I may say so, between small business and large is their ease of attracting capital for investment in the business, for expansion and for other uses. I would think that you are quite correct, that a business generating $60,000 a year in profit before tax would still be in the category of being unable to approach the stock market, the bond market or some of the more sophisticated capital-generating facilities in this country for capital.

The Chairman: Would it be a fair concept that a small business is a business that has to generate its own retained earnings for its expansion and development? In other words, it has not the credit facility and cannot go to the capital market? Would that be one of the tests?

Mr. Ross: It would certainly be so far as I am concerned, Mr. Chairman.

Senator Phillips (Rigaud): Do you see any merit in including in small businesses those that make a profit of up to $35,000, and a further category of those that make a profit in excess of $35,000 and less than $75,000, with the usual notch provision covering all other corporations in excess of $75,000 being subject to the normal corporate rate?

Mr. Ross: An additional step in the corporate tax rate is what you are refering to, sir?

Senator Phillips (Rigaud): Yes. I am thinking of two categories: up to $35,000; and then from $35,000 up to, say, $65,000 or $75,000. It has been suggested in other briefs.

The Chairman: In the area from $35,000 to, say, $65,000 to $75,000 we have what we call a notch provision. That is that as you went up, maybe, $5,000 or $10,000 the rate approached more closely to the 50 per cent, so that when you hit the $65,000 or $75,000 there was a full 50 per cent corporate rate, from there on. Does that strike you as being the way of measuring this?

Mr. Ross: It strikes me as being a very progressive tax base for corporations.

One of the things that has concerned me about the White Paper proposals is that in the individual tax rate they have accepted the premise that people with money have greater ability to afford taxes than those without. It seems to me the same argument can be applied to corporations. Apart from the *White Paper* proposals, frankly some of the detractors of the White Paper have also opted for the proposal of eliminating the split corporate tax rate, but it seems to me this assumes immediately that a business making $20,000 a year is just as able to pay taxes at the same rate as a business making $1 million a year. I do not think this quite follows.

In business, just as in individual life, the first level of profits or the first level of income goes to pay for necessities, and as you get larger, as the individual gets more wealthy and as the corporation gets more wealthy, then they move up from Fords to Chryslers to Cadillacs, perhaps. They are able to buy more of the luxuries, but the basic kind of income is almost all used to pay for necessities. In the corporate sense a necessity can even be to pay for the rate of inflation. Our members traditionally carry a very heavy dollar inventory. If a member of ours is carrying $50,000 in inventory and there is a 5 per cent rate of inflation, the same physical inventory a year later is worth $52,000 or $53,000. He has to generate that $2,000 or $3,000 from some place, and obviously it is on the assets side of his balance sheet and has to be represented by surplus on the other side, and after-tax surplus, just to pay for inflation.

Senator Connolly (Ottawa West): I think the witness is being a little unfair to himself and his argument in the way that he is expressing it, and I wonder whether he would not agree with this. He says that as the business grows and generates more than $35,000 profit or taxable income at the end of the year, it can then afford the things that are more in the luxury end rather than on the side of necessities. I do not think that argument is a good one. I think the argument is that as they generate more capital they can re-invest within their own business out of the capital they generate from its operation, and thereby expand; and it seems to me that what they want in that case is something that is very necessary for the expansion of the business.

The Chairman: They want more retained earnings.

Senator Connolly (Ottawa West): Exactly. But I think, if I might say so, you are hurting your own case when you say that luxury items, unnecessary items, can be acquired. I know you do not literally mean that you go from the Chevy to the Rolls Royce class. I know what you are talking about, but I think if you say that the use of the retained earnings would be to enlarge the business, to increase its capacity to produce, to increase its productivity, to buy better equipment, and that kind of thing, then I think you make an impact on this committee.

Mr. Ross: That is certainly my point, senator. I was trying to illustrate the fact that an organization that makes $1 million in profit and pays $500,000 in taxes still has $500,000 to invest back in the business or to pay out to shareholders, or in some combination; but an organization that makes $20,000 in profit, if it were taxed at the same rate, the high rate of tax is much more dramatic in its case because it is only left with perhaps $10,000-worth of generated profit, after-tax profit, to put back in the business and to pay to the owners.

Senator Benidickson: Mr. Ross, could you expand a little on the fourth paragraph in the Summary of Recommendations, where you refer to closely-held and widely-held corporations and use the word "regressive"?

The Chairman: Excuse me, senator; there are more questions on the subject of small business before we move into the category of your new line of questioning.

I notice on page 45 in your Summary of Recommendations, number 9.8, that you make a suggestion:

> That if the preferred tax rate on the first $35,000 of corporate profits is removed, owners of small businesses be allowed to gain tax relief for moneys left in the business...

Do you mean that they should set up something akin to a retirement savings plan and as long as the money remains in the business, is used in it and not paid out the tax would be deferred?

Mr. Ross: That is exactly what I mean, Mr. Chairman. We have seen time and time again some of our smaller members who have of necessity put every bit of money that they could gather and scrape together over the years into their business, thinking that this physical thing, stock and fixtures, would be salable at the time of their retirement and would provide for their retirement income. We have seen them frequently sorely disappointed that they cannot sell their business because nobody is willing to buy it and they have to distress the stock, or something of that nature.

The Chairman: Yes, but that would not help them.

Mr. Ross: All I am saying, sir, is that because of the capital needs of their business they are prone to pump everything they have into it rather than take out a registered retirement savings plan. In effect the physical plant of the business becomes their fund for retirement.

We are suggesting that some device might be found in order that they may register the business as a legitimate retirement savings plan under these circumstances.

The Chairman: If you have your retained earnings before tax tied up in merchandise it is going to be difficult to withdraw it from the retirement savings plan. Whatever the market will offer will have to be realized.

There may be a germ of an idea there. I am not expressing a view against it, but probing to find the best basis for this purpose.

A straight retirement savings plan with no tax paid on the money paid into it does not help a man in his business. It only provides for the situation at the end of the road, when he wants to retire. We are thinking in terms of the benefit to small business in the period of its operation.

Senator Molson: Perhaps a development along the lines of the suggestion you made at one of our earlier meetings, Mr. Chairman, which is mentioned here, that as long as the earnings are not paid out some special treatment might accrue, would be quite promising or worth discussing.

The Chairman: That would really be a deferred tax.

Senator Molson: It really would be, yes. However, it would provide working capital in the interim, which is very necessary. It would also to some extent cope, or help to cope with the inflationary aspects.

The only thing that it perhaps would not do is provide a retirement plan for the owner, which Mr. Ross just mentioned. I do not know how that would be achieved through that vehicle.

The Chairman: That is something that would have to work itself out, how both these objectives would be attained.

Senator Kinley: A business that closes up generally finds a buyer for only about 50 per cent.

The Chairman: The point then is that if you have a deferred tax benefit during the period when the man is active in carrying on the business, that is fine, he has more money available to put into his business. However, when he comes to the end of the road and has to dispose of those assets a number of things will happen. He may then have to pay his deferred tax, which would reduce whatever remained and his condition would be worse. It certainly could not possibly be any better.

Maybe we are reaching to try to deal with too many things. The idea could perhaps be summed up in the words that you want to give them the benefit of retaining as much in the way of earnings as they can, because they have to provide their own capital. Then they have to wrestle from there on in. Perhaps that is as far as we should go.

Senator Molson: We are confusing in this case the small business problem with the individual problem.

Senator Kinley: The idea is good, because it provides for the end of the road. If a man is 75 and wants to retire and sell his business, it is according to where he is and what the conditions are. He might be left with nothing and no children. The end of the road is a bad thing for a man in retail business unless he has got something.

Senator Phillips (Rigaud): The end of the road is bad for everyone.

The Chairman: Everyone tries to avoid it.

Senator Aird: With reference to the previous comment that one of the criteria might be access to capital markets, I wonder if that is a valid distinction? It seems to me that whether the business be large or small, the owner and the shareholder are concerned about their credit rating. It all goes back to that. This is a criterion that matters.

Many large companies do not go to the capital market, because of their credit rating. This applies to many small businesses. It seems to me that this is one of the tests which goes back to the banking system, rather than access to capital markets per se.

I wonder about that as a test?

The Chairman: That raises an interesting question, senator, which I would like to ask Mr. Ross.

We have a Small Businesses Loans Act, which was enacted some years ago. Its design was to help small businesses by enabling them to obtain bank credit. The test of the small business was on a volume of sales basis. Initially it was sales volume of $250,000, which was later doubled.

Have you any comments to make on that? How has it worked out? Has it been of real value to the small business man?

Mr. Ross: Mr. Chairman, it has not been of notable value to our members at all. I understand now that the Small Businesses Loans Act is almost inoperative.

The Industrial Development Bank, of course, operates. However, there are severe restrictions and limitations on how and when they make loans.

Some of our members have used the facilities of the Industrial Development Bank in a renovation sense with respect to their premises. However, there is no opportunity to pay for increasing inventory, and that kind of thing. The Industrial Development Bank loan has to be for a renovation.

Really the Small Businesses Loans Act has been of very little help. We had high hopes for it at one time, because a small business department was set up, I believe in the Department of Industry, Trade and Commerce.

Senator Kinley: With a market at 10 per cent it is a good thing to stay away from the capital market.

Mr. Ross: It is nice to be able to afford it.

The Chairman: Are there any other questions on this aspect?

Senator Phillips (Rigaud): I should like to put one basic question before we consider the matter to which the honourable senator referred. In order to consider the various suggestions you have to make with respect to capital gains differentiations between types of companies and so on, I am not clear on one point. What is the reaction of your association to the sole conception of integration of income? Do I assume from paragraph 9.2 of your summary on page 44 that you are not in favour of integration, and that in considering your various suggestions we are assuming the abandonment of the integration approach? I think we must know your thoughts on that subject before we can relate your suggestions to this matter.

Mr. Ross: I think it is fair to say that on the basis of what we know now, on the basis of the White Paper, we are opposed to integration of income, because it would destroy the preferred tax, or the partial deferral of tax for small businesses. We are severely hampered, because there have been somewhat nebulous promises of helping small business in other areas if the integration of income concept is adopted, that there will be some other way to help small businesses, without further explanation, so it means that we are put in a position of trading off something we know for possibly something in the future that we have no knowledge about now. I would have to say on the basis of the White Paper proposals per se, yes, we are opposed to the integration of income concept.

Senator Phillips (Rigaud): As honourable senators will be putting questions to you and your colleagues on items such as capital gains and differentiation companies, are we therefore to read your answers in the context of your suggestion that we are to deal with the present law, and that you are against the integration system?

Mr. Ross: Yes, I think that is fair, sir, with the proviso that we are quite open and amenable to the suggestion of something to replace the split corporate tax.

Senator Phillips (Rigaud): In dealing with your suggestion, which we will be coming to in more detail?

Mr. Ross: That is quite right, sir.

Senator Phillips (Rigaud): You are against the integration system?

Mr. Ross: That is quite correct, sir, yes.

The Chairman: Are we ready to move on to the next item?

Senator Carter: There was a question I wanted to ask earlier, when you referred to the deferred tax. I was not quite clear. Would this tax be deferred year by year? In other words, would it be calculated on each year's operations and deferred for each year?

The Chairman: Yes.

Senator Carter: So that at the end there would be an accumulation of the profits deferred for each particular year?

The Chairman: At the end there might be an avalanche. I mean when the whole amount deferred fell in and had to be paid. It is a serious question whether there would be any real or lasting advantage in that. It would depend on the use that could be made of what might be called the tax money that was deferred during the period when it was deferred, and what kind of profit it might generate, so it may be of doubtful advantage to do that.

Senator Benidickson: I would assume that practically all the members of the Canadian Retail Hardware Association would be classified under the White Paper as closely held corporations.

Mr. Ross: Yes, sir, I think that is fair.

Senator Benidickson: In your summary, on page 44 in the fourth paragraph you urge that this distinction between various types of corporations be abandoned, and you use the word "regressive". I wonder if you would illustrate what you mean by "regressive".

Mr. Ross: We use the word "regressive" in the sense that the White Paper proposes to categorize corporations by their character rather than by their level of income. If I can draw an analogy, this is a little like the individual tax rate being different for men than women because of the character of the end user, having nothing to do with their level of income. We feel strongly that in a progressive tax system in corporate tax structure, as well as individual tax structure, any categorization should be not on the character of the corporation but on its level of income, its ability to pay tax. If we could refer to that as progressive on the other side of the coin,

this is why we feel the White Paper characterization is regressive.

The Chairman: You think it is artificial?

Mr. Ross: It creates strange bedfellows; it creates multi-million dollar concerns that are closely held corporations along with our members, some of whom are making $4,000 and $5,000 a year.

The Chairman: You are not objecting to the association if some of it rubbed off?

Mr. Ross: No. We will take all we can get.

The Chairman: Are there any other questions on this aspect?

Senator Beaubien: We have been examining the difficulties and so on of small business under the present tax system. Could we just record that, having recorded that under the White Paper their condition would be very much worse because they would be paying full tax on the first $35,000.

The Chairman: Under the present system they do enjoy the 21 per cent, the lower rate, so that a benefit has resulted from that, and they have been able to generate the earnings they have retained.

Senator Beaubien: Under the new proposals they would pay the full rate.

The Chairman: This is something they would like to retain in some form. That is correct, is it?

Mr. Ross: Yes. We have found that there seems to be a great misconception abroad among many people who read the daily press that for some reason small businessmen are paying less tax as individuals. This, of course, is not the case. They have a 21 per cent corporate tax rate. When they take their retained earnings as dividends they are taxed at their personal tax rate and get a 20 per cent tax dividend credit almost cancelling that, but they in effect pay about the same tax as a partnership would pay if they stripped the profits out of the business.

The present system, of course, allows them to pay that tax in two instalments, 21 per cent in the year the profits are made, and then the balance, the difference between the 21 per cent and the personal marginal tax rate, when they take the profits out of the business. It is therefore only a deferral of the second portion of the tax. Under the present system also, a small business has enjoyed an advantage in that with the absence of a capital gains tax this second instalment of tax could be deferred indefinitely or never paid, simply the business sold and a capital gain taken, this kind of thing. We would suggest that under the provisions now, whereby there will possibly be a capital gains tax, this would no longer hold true. There would be no way of escaping the inevitability of the second portion of tax.

The Chairman: The level of that capital gains tax would be important to you, whether it is 15 or 25 per cent?

Mr. Ross: Yes, the level would be important. There are a number of provisions in the White Paper that allows small businesses to escape the capital gains tax. There is no five-year revaluation. There is no realization on the sale of the business, if it is sold within a family. But what does happen, of course, is that the capital gains tax liability builds up until at the time when there is a sale outside of the family—and inevitably sooner or later this happens to many businesses—then the tax liability is very high.

The Chairman: That is really a deferral.

Mr. Ross: That is right.

The Chairman: Are there any other questions on this aspect.

Senator Connolly (Ottawa West): I have just one question. Having regard to the problem of government in connection with the raising of revenue I wonder if there is anything inequitable about taxing the small business at the lower rates which are now prevalent and not allowing the larger corporations, as I understand it, to pay at the lower rate for the first $35,000, and so on up the scale. In other words, to tax the small business at a designated amount, but if a business is not in that category for taxable income purposes then it should bear the full rate.

The Chairman: The White Paper proposed the full rate for all corporations. The proposals we have discussed here have been ones that would make the 21 per cent rate available only to small business and any business that did not qualify as a small business would be subject to the full corporate rate.

Senator Flynn: Senator Connolly is suggesting that there is a reduction in the rate for corporations earning more than $35,000.

Senator Connolly: There was a witness here sometime ago who said that as far as his

company was concerned the savings were minimal and that it did not matter whether they had it on the first $35,000.

The Chairman: I believe that was either Gulf or Shell.

Senator Connolly: It was one of the larger ones.

Mr. Ross: In my opinion this would be a disincentive to growth. If they are taxed at 21 per cent and they are making $34,000 worth of profits, what you are suggesting is that when they go up to $36,000 worth of profit they will be taxed on everything from the first dollar of profit at 50 per cent.

Senator Connolly: Actually, I would vote that there would be various notches.

The Chairman: Up to a higher figure maybe $65,000 or $75,000.

Senator Flynn: Since the White Paper is trying to get more, it is difficult to reconcile your proposal with the philosophy of the White Paper.

Senator Beaubien: It gets more, but it does not say that it wants more.

The Chairman: That is correct. What is the next heading? You have mentioned, Mr. Ross, about accelerated capital cost allowances for all businesses. That has been discussed as being a method of giving some relief and an additional benefit, but it is not the complete answer.

Mr. Ross: That is exactly our point of view, Mr. Chairman. We mentioned it in our brief only because Mr. Benson himself has mentioned it as a possibility of providing relief to small business.

Without too much further explanation we do not think that accelerated capital cost allowances will help our members too much, because the biggest asset for our members is inventory which increases all of the time. Capital cost allowances are not ordinarily allowed against inventory increases. We would like to see accelerated capital cost allowances as a stimulus to expansion of small business, but we do not think it replaces what would be taken away.

The Chairman: It would not be available in relation to your major asset.

Mr. Ross: That is quite true.

Senator Phillips (Rigaud): You are suggesting it as a supplementary benefit rather than a replacement of the lower rate of taxation up to a certain amount of profit.

Mr. Ross: That is right, senator Phillips.

The Chairman: You do not recognize it as a solution to your problem.

Mr. Ross: No.

Senator Molson: In paragraph 9.6 on page 45 you speak about capital gains. May we assume that you are not in favour of a capital gains taxation at the personal income tax rates?

Mr. Ross: Yes sir, you may assume that.

Senator Molson: I have one other point. What is your view on the taxation of principal residences?

Mr. Ross: We have not taken a position on that in the brief. I would hesitate to answer you, senator, as a spokesman for the association. However, I have individual views on it.

The Chairman: May we have those views, and we will note that you are speaking as an individual.

Mr. Ross: All right, sir. I am quite opposed to the capital gains tax being applied to a principal residence.

The Chairman: Why?

Mr. Ross: Because the value of real estate in any area fluctuates tremendously. I happen to live in the Toronto area. Anyone who lives there knows of the tremendous increases which have developed in the cost of real estate over the last few years. If the White Paper proposals had been implemented a few years ago and I had been forced to sell my house I would have to pay a considerable amount of tax, and yet I would have to go into another house at the inflated values of which I sold my house. I can see the capital gains tax being applied to somebody who trades in real estate as a business.

The Chairman: I have news for you. That situation exists now.

Senator Beaubien: At the full rate?

Mr. Ross: That is right, because it is a business profit.

In regard to the homeowners and their principal places of residence I do not quite see the equity in this kind of a situation. If they sell at inflated values they are also

buying another place at inflated values. They are not going to live in a tent.

The Chairman: I believe that in the United States they provide for a roll-over and I think when you reach a certain age—I think it is 65—and sell your residence you escape capital gains tax. Of course, some of the honourable senators do not have to be concerned about that because that is some time ahead. Are there any further questions?

Senator Molson: Would Mr. Ross care to make any further comments on paragraph 9.11 which deals with *bona fide* business expenses. He has mentioned conventions and seminars. May I take it that your view is that legitimate expenses for business promotion have their proper place in the accounts and should be allowable for tax purposes.

Senator Phillips (Rigaud): Mr. Chairman, may I ask Senator Molson if he would allow me to pursue the capital gains aspect, because I had intended to put a question on that.

Mr. Ross, as far as I remember this is the first brief where we have the suggestion that capital gains tax at a flat rate should not be applied to the sale of small businesses altogether; that is to say, that small business should be completely exempt from taxation by way of capital gains. I am referring to paragraph 9.7 on page 45. We cannot deal with accelerated depreciation because the minister in the White Paper merely says that it will be considered, et cetera, and it is no use talking about something that has not yet been developed. But, with respect to capital gains I think you are the first ones to come before us and state that if we have a capital gains tax in Canada it should not be applied to the sale of small businesses.

Mr. Ross: Senator, perhaps I might explain that first of all under the provisions in the White Paper there would be virtually no chance of a capital gain in...

Senator Phillips (Rigaud): I am interrupting you, but we have covered that. That is why I put the basic question as to whether you are in favour of integration, and you said that you were not.

Mr. Ross: Yes.

Senator Phillips (Rigaud): Then, based upon the assumption of a capital gains tax, the chairman asked you: Are you in favour of a flat rate?

Mr. Ross: Yes.

Senator Phillips (Rigaud): With these two assumptions behind us we are dealing with the situation of the application of a capital gains tax, non-integrated, at a flat rate. Within that framework are you suggesting that if a small business were sold and a capital gain made—I am not speaking of a sale within the family—that no capital gains tax should be exigible? I read your paragraphs to so say. I am not against that suggestion when its objective is the development of incentive, but I want to know if that is your suggestion.

Mr. Ross: The suggestion was written having in mind that the greater weight of corporate taxation would fall on the retailer, in effect. If we assume that the White Paper's corporate tax provisions are adopted, and small businesses are paying a 50 per cent corporate tax on their profits, then the other 50 per cent that is left in the business, and which accrues to the surplus of the business, should not have a capital gains tax applied to it when it is taken out.

Senator Phillips (Rigaud): May I, with the consent of the chairman, pursue this question?

The Chairman: Yes.

Senator Phillips (Rigaud): Once we accept the principle that these will be applied to small businesses as defined a special rate of taxation, have you entertained the thought that there may be a lower rate of taxation in respect of capital gains applicable to the sale of small businesses? In other words, if you had a capital gains tax at a flat rate of 25 per cent in Canada, in order to encourage a hard core of good Canadian citizenship in terms of building up businesses and the like, have you entertained the thought that the owners of small businesses, when they sell their businesses, should be subject to a lower flat rate?

Mr. Ross: We have not entertained that thought.

Senator Phillips (Rigaud): What do you think of it?

Mr. Ross: Politically within my organization I would have a very difficult time in arguing it.

The Chairman: Do you mean you would have a difficult time arguing against it?

Mr. Ross: Yes, arguing against this stand that the senator has taken. I am sure that there are many ramifications that I have not

considered. I just do not know how to reply to your question, senator, because I had not thought of taking something in this preferential area and suggesting there be a split rate in the capital gains tax.

Senator Phillips (Rigaud): You are talking of a preferential rate for small businesses on earned income.

Mr. Ross: Yes.

Senator Phillips (Rigaud): Then what is your philosophy in this disinclination to argue for a preferential rate in respect of a capital gains tax?

Mr. Ross: We were considering mainly the problem of expanding businesses. When the capital gain is taken the man is leaving the business, or is selling a portion of his ownership. It is not an expansion kind of situation.

The Chairman: Senator Phillips, you will notice that if your capital gains tax is a separate and distinct tax, and is not classified as income, then, of course, whatever the rate may be there is no integration, and you do not pay at the marginal rate of the person who makes the gain. You pay the specific rate. So, if you had a fixed rate, whether it be 15 per cent or 25 per cent, there is no bringing of that into your income, so there would be an advantage in that.

Senator Flynn: I should like, Mr. Chairman, some clarification of paragraph 9.7. It reads:

> That capital gains tax be not applied to surpluses of small businesses on their sale in recognition that the surplus is generated from tax-paid profits.

I suppose you have in mind a small business that is incorporated.

Mr. Ross: Yes, sir.

Senator Flynn: And you would say that the added value of the shares in a small corporation would result from tax-paid profits and, therefore, it would not be fair to impose a capital gains tax on them. Is that your reasoning?

Mr. Ross: That is part of the reasoning, yes, senator, the point being, of course, that the most anybody gets when they are selling the capital stock of a hardware store, for example, is the book value of the hardware store, and perhaps a little bit for the goodwilll There are provisions for the taxation of goodwill elsewhere in the White Paper, so that it is not quite the same as buying and selling shares on the stock market, where you can get a capital gain based upon the anticipated future growth of earnings. So, it is the value of the assets, less the liabilities.

Senator Flynn: I agree with that, but I think you are injecting here something which has not been considered. If the increase in the price of the stock, whether it be a small commpany or a large company, is the result of a surplus generated from tax-paid profits, then it is not really a capital gain, but it would be taxable under the proposals in the White Paper.

Senator Beaubien: That is a good point.

Senator Flynn: This strikes me as something that has not been touched upon as yet.

Mr. Ross: The small business has an escape clause in that it can opt to be taxed as a partnership at the marginal tax rates of the owners. In effect they can take their money out of the business, pay tax on it, and put it back in as tax-paid capital. It is then not a capital gain. But, if they are so incautious as to pay tax at the 50 per cent rate, and not take out the other 50 per cent for two and a half years, then the balance of 50 per cent that is left in there accrues to the surplus as a capital gain, and can be taxed again at the rate of 50 per cent.

Senator Flynn: So the only way to avoid the tax...

Mr. Ross: ...is to strip the profits out.

Senator Flynn: ...is to take the profits out?

Mr. Ross: Yes, strip them out at least as a stock dividend.

Senator Laird: Mr. Chairman, while we are on capital gains would this be a good place at which to obtain an expansion of the witness's views on the proposal to tax unrealized capital gains?

The Chairman: Yes, but I would be surprised if his answer is not what I think it will be.

Senator Phillips (Rigaud): The chairman is not intending to lead the witness?

The Chairman: No.

Mr. Ross: Again, you have hit upon an area that we have not covered in our brief, because this has not an effect on small busi-

ness. The White Paper proposals are quite specific that in respect of family-owned businesses there is no five year revaluation, but there is a roll-over provision that applies when the business passes from one generation to another within the same family. So, in effect, for the small business there is not a tax on unrealized capital gains.

The Chairman: Except, Mr. Ross, you have to qualify that. At any time when the plan is to move that small business out of the family, then you would run into that problem of deemed realization.

Mr. Ross: Well, it would be actual realization, would it not, Mr. Chairman, in that case?

The Chairman: Yes, that is correct.

Mr. Ross: If it was sold outside the family it would be an actual cash realization.

The Chairman: The person acquiring it might be influenced by his acquisition cost, if he is building himself into this business, because you cannot start the family interest all over again, I take it.

Mr. Ross: Well, again it is something that I have personal views on but not so far as the association and the brief are concerned.

The Chairman: Are there any other questions on that aspect?

Senator Phillips (Rigaud): I believe I interrupted Senator Molson, Mr. Chairman.

Senator Molson: Mr. Chairman, I just wanted to clarify the record with regard to paragraph 9.11, dealing with legitimate business promotion expenses. If I may take an instant to clarify what I am going to say, Mr. Chairman, I don't wish to be quoted in the press as having said that I think the term "entertainment expenses" was unhappy but that proper business promotion expenses for such things as hockey tickets, dining and wining at private clubs, was allowable or permissible.

The Chairman: Well, Senator Molson, why don't you finish the sentence by saying that, if they have been allowed under the present system, the language of the present statute is such that they might be construed as not being a reasonable expense laid out for the purpose of earning income so that it is within the scope of the present law to rule them out.

Senator Molson: That is what I meant, and I meant at that time that entertainment expenses just for the purpose of entertainment had no place in our discussion or in any statement, but it ended up in the other way with my "suggesting" that proper business expenses include those items.

I just want to ask what the view of the association is with regard to all types of proper business expenses laid out for promoting their businesses, because there is a wide range of types of expenses and I am including all those which, coming within the meaning of the present regulations, are properly laid out to earn the income.

Mr. Ross: Well, senator, I realize as most of us do that probably abuses have occurred in these areas. We do not hold a brief for the continuance of abuses. There are legitimate promotional expenses that we believe very strongly are legitimate expenses of carrying on business that should continue to be allowed. One thing we are very tense about, because we are an association, is the proposal of the White Paper to disallow convention expenses. We know even in this area that there have been a great many abuses. I am rather close to association work; I see an awful lot of convention work; it is part of my job and I have seen a lot of abuses take place. But certainly they don't take place in our case. We have a very busy work convention. Our association, believing that the main problem of the small retailers in our membership today is lack of adequate management training, has for two years now been running very extensive management training seminars to the cost of the association of over $100,000 in the last two years. We have had to fund this. Now, the people who attend those seminars are not having a good time. There is just absolutely no social aspect at all to the seminars. But because we ask the person coming to participate financially in order to defray some of our expenses, we are afraid now that if we have to ask him to do so out of after-tax-dollars rather than before-tax-dollars that that is going to be a disincentive for him to participate.

Further, we think there is an inequity involved if the system does not allow independent businessmen to get together to exchange views out of before-tax-dollars when a large multi-unit chain operation can bring its managers together in training sessions and policy sessions and, because it is an internal thing, still have that included as a legitimate business expense. That is, in fact,

penalizing a man for being independent. So we think there is a basic equity for allowing these things.

Again, as the Chairman has explained, the devices are there within the present Income Tax Act to control the obvious abuses in this area at least.

Senator Macnaughton: Mr. Ross, in paragraph 9.17 on page 47 of your recommendations is there some hidden meaning that I cannot understand? You recommend that the Government clearly and concisely outline its need for an ever-increasing proportion of the gross national product of Canada whenever tax increases are proposed or implemented. But you have the White Paper before a budget is brought in. You have the budget proposals. You have the outline by the Minister of Finance in introducing his budget and in explaining why and where and so on. What do you mean by that expression, "outline its need"?

The Chairman: I think I know what he means.

Mr. Ross: What we are getting at, senator, are the points of the White Paper itself, as opposed to a yearly budget when the Minister of Finance comes in with a balance sheet for a country, a profit-loss statement or a loss statement for the country. That is imposed on the people, but at least the people have an opportunity to assess the direction of the tax dollars that he is collecting. They know what they are going to pay and that kind of thing. But in the White Paper proposals we don't have that. There has been some discussion, as you know, at the provincial-federal level as to the level of revenues that the White Paper proposals would raise, or the increase of revenues that they would produce. We don't think the Minister of Finance has explained the need for increased revenues in this case as opposed to the yearly budgets.

Senator Flynn: You are suggesting that the minister has always explained that it was not the purpose of the White Paper to increase the revenue. That is the attitude taken by the minister, but in a way it is a hidden form of increasing the taxes.

Mr. Ross: The political language surrounding the White Paper has been couched in one word: "equity". But it does seem to support an increased tax revenue.

The Chairman: I think what he is saying, Senator Flynn, is that in the ordinary way in budget-making the minister outlines his requirements. He makes an accounitng and outlines his requirements and then he puts forward the tax proposals, if he needs more money, and this is the correlationship. But the effect of the White Paper, when you add the whole thing together, is to produce substantially more tax; yet in the White Paper nowhere do you find any explanation of why it is needed or in which direction it is going to be used. That is your position, Mr. Ross?

Mr. Ross: Yes.

Senator Molson: It is called reform.

The Chairman: It is called reform of taxes, yes.

Senator Desruisseaux: Mr. Ross, on page 40 of your brief, paragraph 7.27, you state that many family businesses will terminate with the present generation if the proposals become law.

From your experience with the association what would be your appraisal of the percentage of people who could so give up their businesses? And in what order of importance would you list them?

Mr. Ross: Anything in that area is pure speculation, of course, senator.

Senator Desruisseaux: Yes, of course.

Mr. Ross: We are guided to a certain extent, sir, by the fact that, as you know, the estate and gift taxes changed a little over a year ago. They were dramatically increased and we have noticed since that time a very dramatic increase in the very difficult job of passing hardware stores or member stores from one generation to another. These people had made arrangements to look after estate and gift taxes under the old system and have perhaps been buying into an insurance plan or something of that nature for a number of years, and suddenly it became out of date about one and a half years ago. There has been a great number of difficulties since then. We are suggesting that the White Paper proposals would further complicate that process and compound the complication already introduced a little over a year ago by the new estate and gift taxes. This applies mainly in the area of incentive entry. It is no secret that it is very difficult to sell a hardware store or any business if you cannot find anybody wanting to buy it, and if the incentive to enter a high-risk long-hours business is lost, then it very severely complicates the problem

of turning it over. This applies particularly if the son does not want to go into the business perhaps.

Senator Desruisseaux: But that would not be a major consequence of the number of people withdrawing because of the proposal.

Mr. Ross: Purely and simply because of the White Paper proposals?

Senator Desruisseaux: Yes.

Mr. Ross: I don't know. The White Paper proposals in combination with the estate and gift taxes of just over a year ago are responsible, I think, for a fairly good number. If our mail is any indication, we have heard from a great number of members who are very much concerned with this aspect alone. They feel they are building up an equity for their children and now they are going to be faced with a capital gains tax. They do not know, of course, on the roll-over that it is not going to be applied to them, but they seem to be overly concerned with their ability to pass on an estate in this physical form of a hardware store to their issue.

The Chairman: Mr. Ross, one of the points you have raised in your brief deals with the proposed tax on investment income of associations. What have you to say about that?

Mr. Ross: There are two aspects to this. This does not really concern our members, but it does concern our finances as an association. We are organized as a non-profit corporation and therefore do not pay taxes. We do not make a profit either. At least, we are incorporated not to make a profit. Some businesses do not make a profit either although they are supposed to do so. This applies more and more.

The Chairman: But the fact that you are incorporated as a non-profit organization does not guarantee you against loss.

Mr. Ross: No, it does not. It is just that we are first of all concerned about the inequity in the White Paper inasmuch as it exempts religious and labour organizations. This seems to say to us that employer groups, such as we are, are going to have to pay full rate corporation taxes on our investment income but employee groups will not be so required. This seems to be the case with labour unions. This seems to be a basic inequity which, in reading the White Paper proposals, never seems to be explained. There is never any reason given for this differentiation in any of the documents that I have been able to read.

The second thing, of course, is that when we are recognized as a non-profit organization, we would probably end up by paying 50 per cent of our investment income—which is not large, last year it was $8,000—and we would end up by paying 50 per cent of that investment income in tax, because we are not set up to charge expenses against this one occupation separately, this one occupation of investing money to return a profit. We do not end the year ordinarily with any kind of profit. So that regardless of where our income comes from, it is returned to our members, and we would be less than efficient if we did not use their money which they deposit with us once a year in terms of membership dues, and we return it over the course of the year as membership services. We would be terribly inefficient if we did not make money with their money in short-term investments during this short period of time. To have to pay 60 per cent of that in taxes does not make any sense to us. If in the overall, our operations are not profitable, that, I think, should be the judge of the matter as to whether we pay taxes or not.

The Chairman: Maybe your membership arrangements should be drawn in such a way that people are paying on account of membership, and if they overpay, you give them a refund.

Mr. Ross: A co-op.

The Chairman: That brings me to my next question. You do talk about co-ops here. What is your comment on co-operatives?

Mr. Ross: Well, Mr. Chairman and gentlemen, we have a great number of our members, particularly in the Maritimes, in the Province of Quebec and on the Prairies competing most strongly with consumer co-operatives. The hardware field is a field which consumer co-operatives have invaded in large numbers, possibly because it is a logical extension of the farm supply store, I suppose. We have for years been very outspoken in petitioning the Minister of Justice and the Minister of Finance of this country to tax co-operatives on the same basis as ordinary incorporated businesses because they are competing directly with other businesses. At least in our case they are. Let me say that we were heartened to see that the White Paper recognizes that there has been an inequity here by taking away some of the special privileges enjoyed by the co-ops over the last

number of years. But we find it very difficult to explain why the White Paper in recognizing the inequity would not take away all the special privileges rather than just a portion of them. This is like being half-way guilty, or if I may, Mr. Chairman, a little bit pregnant. It is a situation where you either are or are not.

Senator Phillips (Rigaud): That is a very creative thought.

The Chairman: It must have been provoked by all the furore that took place in the last few days about free abortions.

Senator Flynn: Have we had any indication from co-operatives that they would come to us and present a brief?

The Chairman: Yes, we have. They will be on next week.

Senator Flynn: Is it the idea that they recognize that they should not continue to enjoy any special privileges?

The Chairman: I am not sure that they will say that.

Senator Desruisseaux: I would like just a small clarification. I am assuming that you have no co-operative members in your Association.

Mr. Ross: Strangely enough, senator, we do have a few. We have a few misguided co-operatives. No, that is hardly true. Federated Co-operatives of Saskatoon, on of the largest retail stores and one of the largest merchandising Co-operatives in Canada, is a member of the Association. We do not refuse them membership when they come to us, but we do not actually solicit membership either because we have taken such a strong position with regard to the taxation benefits that they have that we thought that we would be talking out of both sides of our mouths at the same time if we were to solicit their membership. We have not solicited them, but when they have come seeking membership, we have accepted them. We have a few of them.

The Chairman: Is there anything else you want to say? Do you feel that we have overlooked anything? Is there anything else that you would like to add or that any member of your panel would like to add?

Mr. Valiant: No, sir. It has been most fair, most fair.

The Chairman: Do you have something you would like to add, Mr. Lochead?

Mr. A. G. Lochead, President, Canadian Retail Hardware Association: Mr. Chairman and gentlemen, it has been a great pleasure for myself and for the others in our delegation to have had the opportunity of presenting the views of our members to this distinguished body. Allow me to thank you most sincerely for your courtesy.

Our views on the White Paper proposals will be just one set of many you will receive. If we have tended to become emotional in the presentation of our views, either in the brief or during this appearance, we ask your understanding.

Our attitude is strongly influenced by the fact that we firmly believe we have been discussing the very survival of the independent hardware retailer as a competitive and viable economic unit in our country.

We recognize that nobody wishes taxation, but everyone wants the benefits that governements provide through taxation revenues. We sympathize with the momentous decisions that this committee must explore and recommend. We earnestly solicit understanding of our views. The independent hardware retailer is taxed by all levels of governement, and all require increased revenues.

We suggest that there is a point in taxation beyond which the risk, the long hours, the personal investment are no longer worthwhile. Taxation can destroy initiative of individual businessmen and of whole groups in this category.

We are afraid of the White Paper proposals, afraid that they may virtually eliminate independent retailers in one generation and concentrate distribution power in the hands of the mass merchandisers.

We do not ask for special privileges, only the freedom and opportunity to compete in a business climate that already favours large business in so many ways. We want to exist, to expand, to serve our communities and employees.

We need the help and understanding of a tax structure which recognizes the greatest needs of small business, the incentive and capital requirements of expansion.

Thank you again for your interest and courtesy, gentlemen.

The Chairman: Gentlemen, the next brief we have—and this will be the first one to be presented in French—is from Noiseux, Lyonnais, Gascon, Bédard, Lussier, Senécal & Associés. Will you gentlemen come forward?

Senator Desruisseaux, will you come up here and keep me from slipping into error?

Senator Phillips (Rigaud): We all know the honourable Senator Desruisseaux to be an outstanding lawyer. Has he established his credentials as a linguist?

The Chairman: I was prepared to take them as read and approved.

Senator Desruisseaux: May I say that I thank the Chairman for his indulgence. I will do what I can, but I am not an authority—or a recognized authority, for that matter.

Senator Phillips (Rigaud): The remark was meant to be facetious.

[*Translation*]

Mr. Paul Noiseux, C.A.: Mr. Chairman, Members of the Senate Committee, we are a Montreal group of chartered accountants, practising for 25 years. We have attentively studied the proposals contained in the White Paper on Tax Reform, and we have been asking ourselves questions, in other words, we have been thinking about it. We have been struck by the sub-edited evidence that is often found throughout the pages of the White Paper, and we are more concerned by the proposal to remove, to abolish, the 20 per cent preferential rate in the Province of Quebec on the first $35,000 on profits. Our clientele, made up of small and medium-sized businesses, which we have seen expand through all their phases, often family or small operations, into average-size firms, we believe that these businesses have profited throughout the years from this below 23 per cent rate. In our opinion, the effects are going to be to draw annually, in taxes, on small corporations, a sum that we estimate at $452 million. Others have put forward the opinion that this figure will be between $395 and $400 million.

Senator Beaubien: That is throughout Canada, 400 million?

Mr. Noiseux: Throughout Canada. Out of a total, which represents almost 80 per cent of the increase that is expected to be drawn from corporations.

Senator Giguere: That is in 1974?

Mr. Noiseux: Yes, in 1974.

Senator Beaubien: That is 400 million per annum by 1974. That represents, you say, 80 per cent, then, on the increases on—

Mr. Noiseux: Shown in table 16 on tax proposals, and a total increase of 560 million is expected for corporations, large and small.

Senator Beaubien: Everybody.

Mr. Noiseux: We think—and I have gone over that figure using other calculations—we have estimated that they are going to draw, that the small business—perhaps I should take a moment to explain what we mean by a small business. We do not want to defend a small business as necessarily being a philosophy of challenge but rather as being a stage in the development of a business. Hence, we think that businesses, whose profits are below $100,000 a year, will contribute almost 450 million of the expected 560 million when the tax proposals are in force in 1974 and 1975. There is currently talk about tax interpretation in the White Paper, and we might wonder whether the small businessman, the small business will not profit by the tax integration of the increase. There again, we have taken examples, and you have an example here, obviously, that we have prepared: someone who would have an income in his small business of $35,000, after paying himself a salary of $15,000, as the principal shareholder—I think that you have there—he would have a tax increase of $9,773. There would be a net tax increase of $9,773. Thus, we do not see the compensation that the word "integration" seems to want to give to that. Then, in our experience with that type of corporation, that leads us to think that, if a sum of $400 to 450 million is drawn in re-investments, we are thereby going to come to the source of the short, medium and long term loan of the small or medium sized business. The small business generally borrows from financial institutions, the Industrial Development Bank, RoyNat, the Industrial Credit Bureau of the Province of Quebec, and similar institutions. Our experience, since the days of such long-term loans, is that such institutions require from the borrower equity equal to the amount of the loan requested. If $400 to 450 million are withdrawn, we may think that another 400 to 450 million will be withdrawn from possible short, medium and long-term loans. When we think that—

Senator Beaubien: 900 million?

Mr. Noiseaux: 900 million. When we think that current loans from the development bank—I do not have the exact date, but last year—amounted to approximately 416 million for all current loans, and we fear that 900 million will be withdrawn annually. Then,

there is a difference which may help us affect the small or medium sized business.

Senator Giguere: Where small and medium sized businesses are concerned, do you class them under 100,000?

Mr. Noiseux: Yes, I do not want to become bound to a system of small businesses. Our clients may become medium sized businesses, a national firm that started from small businesses.

Senator Desruisseaux: May I interrupt you here, Mr. Noiseux? I would like to ask you whether you have supporting facts for arriving at your figures, a study of supporting facts?

Mr. Noiseux: Yes, that is, 450 million, for example?

Senator Desruisseaux: Yes.

Mr. Noiseux: It is strictly from the White Paper, table 16 of the White paper.

Senator Desruisseaux: With the compilation you made to give this number?

Mr. Noiseux: Yes. All the figures are taken from table 16 which appears in the White Paper.

Senator Flynn: That is only a mathematical calculation, is it not? It does not take into account the expansion which might take place within four years, it is simply a mathematical result of the application of the proposals in the White Paper. That expansion could be much greater?

Mr. Noiseux: Absolutely.

Senator Desruisseaux: Nor does it take into account the devaluation of the money which occurs annually?

Mr. Noiseux: No. Let us say that we have been very pragmatic, very much the accountants, and that we have taken the figures of table 16 exactly, and we have tried to interpret them.

Senator Desruisseaux: But, to arrive at your figures, your tabulation to arrive at your figure of 452 million?

Mr. Noiseux: Would you like me to give you an explanation?

Senator Desruisseaux: Yes, if you would.

Mr. Noiseux: I will read you the text that I already have. The elimination of the lower rate will affect both the widely-held and the closely-held corporation. At present, all corporations profit from this first rate. This is what I mean: all corporations profit, gain on that rate, on the first $35,000; this is not a granted advantage. In table 16 of the White Paper, it is expected that there will be an increase in tax revenue, resulting from the elimination of rates below 23 per cent, of 95 million starting the first year. It should be remembered that, the first year, all companies that make more than $105,000 of profits, for them, the advantage of the increase is eliminated immediately. Hence, in the 95 million increase, it can be expected that a certain percentage of the small corporation—let us say that we have made an estimate—and I think that 50 per cent of that amount, 47 million...

Senator Desruisseaux: Excuse me. This 95 million, where did you take that from?

Mr. Noiseux: That again is in table 16.

Senator Desruisseaux: In table 16. That's fine, thank you.

Mr. Noiseux: It is item 1, table 16. Table 16 also indicates that the elimination of the lower rate will increase tax revenue by 390 million by the fifth year. If the advantages of the rate below 23 per cent disappear the first year, for the large corporation and the corporation whose profits exceed $105,000, it is therefore the small corporation that will bear the costs of the increase from 95 to 390 million. And this is because they propose to reduce that 35,000 in 7,000 stages each year. Then, we have an increase which amounts to 295 million. I can continue because there are two other figures which are also in the tables. Table 16 gives a sum of 60 million for the dividends of a Canadian corporation, and of another corporation, dividends which, at the present time, are not taxable. That gives 60 million; that is item 2; taxing dividends which closely-held corporations receive from widely-held corporations which the White Paper fixes at 60 million. And our last figure is an estimate which might explain the matter, who would pay the capital gains at the corporation level. Would it be the large corporation who would pay most of the taxes on capital gains, or would it be the small one? These percentages, it is almost impossible to say. We note that in the United States it is more often the small taxpayer who pays most of the taxes on capital gains. We estimate that, let us say, at 50 million. This is at

present—what I referred to when I said from 400 to 450 million.

Senator Flynn: Mr. Chairman, I believe that Mr. Gilmour had prepared figures for us on the effect of the White Paper's proposals concerning small businesses.

Mr. Noiseux: I hope that they will be fair.

Senator Flynn: I feel that they are conservative to date.

Mr. Noiseux: Mr. Chairman, I believe that the predicted result is the probable disappearance of the small business, controlled, we might add, by Canadians, to the advantage of the large concern, generally not controlled by Canadians. Elsewhere in the brief we add that when assistance is given to a small or average business, an authentically Canadian business is being assisted which is not always true in the case of a large firm. We continue by outlining what we feel are the reasons for protecting the small firm. In our brief we are somewhat prejudiced, perhaps, in reporting the budget speeches which led to the imposition of the lower rate, the first of $10,000, then $15,000 and finally $35,000; each time, the small business is praised. We feel that authentic innovations, regional expression and manifestations of the special genius of Canadians are more possible within the small enterprise. An example of this is the snowmobile industry in the Province of Quebec. The industry which has sprung up entirely through small firms has experienced a phenomenal growth. We believe that, initially, the owners of small businesses have modest needs and their prices, as a result, are very competitive and thus generally profit the population. We believe that the creation and progress of small businesses is a gauge of wider creation. I like to think that the economic growth of the United States and the multiplicity of their large businesses stem, whether we wish it or not, from firms which initially were small and which amalgamated, certainly, which disappeared through necessity. However, after a number of years, they probably gave rise to big business. Small concerns are largely in Canadian hands. Can we say as much for the large concerns? Small firms also account for jobs. Statistics have shown that 46 percent of the labour employed in Canada is employed by firms whose average labour force is 200 workers.

Senator Beaubien: 46 percent?

Mr. Noiseux: 46 percent. This is the figure we came up with at one point. The Carter Report which recommended the abolition of the lower rate had enormous influence in the percentage of the small concern. Among other things, the report recommends certain compensations such as an increase in the amortization quota. We do not necessarily subscribe to this form of assistance, but we believe that, in the long run, our taxation system should provide for a tax for small businesses and, here again, not because they are small, but because the small concern is the start of larger ones. We limited ourselves to this point, to the lower rate of the first 35.000 for our brief.

Senator Flynn: In other words, you recommend retaining the present system in principle?

Mr. Noiseux: In principle. The only change we should like at this point—we also use the word "integration" to attract some attention; we are not speaking of integration as understood in the White Paper. We feel that the dividend is a return on capital and, as such, should be a deductible expenditure in the hands of the company paying, and remitted by the shareholder receiving it. This is the only improvement we would suggest in taxation.

Senator Beaubien: Then the dividends would be paid before paying the taxes?

Mr. Noiseux: That is correct. We are speaking of the shareholder receiving them.

Senator Beaubien: It is a point...

Mr. Noiseux: We are not the author.

Senator Beaubien: No.

Mr. Noiseux: We assume it after others.

Senator Beaubien: This is what you are saying?

Mr. Noiseux: Yes.

Senator Beaubien: The shareholder would be required to pay the tax 100 percent?

Mr. Noiseux: Yes.

Senator Flynn: And would not have the same reduction.

Senator Flynn: It is as if the amount paid by the shareholders were actually a loan invested in the company; you invest your money as the bank invests its money by lending it to a corporation. Is this your idea?

Mr. Noiseux: Our claim—here again it is not an original one as we have seen elsewhere—is that a dividend is quite simply but a return on capital.

Senator Flynn: Given this, tax revenue would certainly diminish as a general rule.

Mr. Noiseux: Yes, but more so for the individual; there would be a fair amount of compensation.

Senator Flynn: And you have not arrived at any figures on the matter to determine what would be the mathematical consequence on the...

Mr. Noiseux: Yes. It requires fairly complex data; the taxpayer who receives a dividend pays tax rates at all levels. His only consolation is his 20 per cent credit; his tax varies.

Senator Flynn: It is already an index from which conclusions could be drawn.

Senator Phillips: Are you in favour of a special basis, if you realize profits between $35,000 and $75,000? Are you in favour of a special rate?

Mr. Noiseux: A rate...?

Senator Phillips: Because you only mentioned up to $35,000?

Mr. Noiseux: It would be an intermediary rate between...

Senator Beaubien: The other levels.

Mr. Noiseux: I feel that it is an excellent suggestion.

Senator Phillips: You are in favour?

Mr. Noiseux: It would be an additional incentive to business.

Senator Flynn: Perhaps we could gives these figures to the witness and if, having studied them, he should reach somewhat different conclusions, he could perhaps submit comments on the figures prepared by our...

Mr. Noiseux: I agree.

Senator Phillips: Here you have the figures with the explanations.

Mr. Noiseux: Already I believe that we have the same figures, or approximately the same. Mr. Gilmour speaks of 35,000; we go as far as 105,000.

Senator Phillips: But as Senator Flynn said, it is important to obtain your explanations.

Mr. Noiseux: We are still speaking of the same table; may I...

Senator Beaubien: Yes.

Mr. Noiseux: In a book which we read recently, a study which was—to justify our use of the 50 per cent—which was chosen by the corporations.

When we take 50 per cent of the capital gains paid by the small corporation, I believe that this is perhaps a conservative estimate.

Senator Molson: To follow up your proposal, one has to define the "corporation".

Mr. Noiseux: In the 100,000, is that what you said?

Senator Molson: Not exactly. Only the corporations which realize profits of 100,000, whether small crporations or not. I feel that the figure can be changed.

Mr. Noiseux: Essentially, it can be placed at any figure, let us say between 35,000 and, if the first 35,000 is taken care of, $100,000 in profits.

Senator Molson: Yes, but you think there could be a base of 35,000 and that it could increase in stages up to 100,000?

Mr. Noiseux: Yes, I am completely in agreement because, once again, in our opinion, the small business is the business which is developing.

Senator Beaubien: Yes.

Senator Molson: You are not considering the sales figures for the small corporations but rather the profit figures?

Mr. Noiseux: I prefer to base my considerations on the profits.

Senator Flynn: We are in the field of taxation.

Mr. Noiseux: Yes, because volume depends on the type of firm. Volumes vary enormously.

Senator Molson: Yes.

Mr. Noiseux: Today a grocer whose volume of business amounts to $500,000 per year is still a small grocer.

Senator Flynn: He can also make a million and obtain as net profits only $25,000.

Senator Phillips: If we are speaking of taxes, we are speaking of profits is that not so? It is not a question of volume.

Senator Beaubien: A profit of 1.5 percent...

Senator Molson: Not the used capital...

Mr. Noiseux: Once again, I feel that it is much less.

Senator Molson: So do I.

Senator Flynn: It would probably be a problem of depreciation.

Senator Giguere: For the purposes of taxation, the only basis can be profits.

Mr. Noiseux: That is correct. There are other items of taxation; there is a tax on volume.

Senator Giguere: In our present system, this is the only standard which can be used.

Mr. Noiseux: If one uses the same standard for placing the firms, I feel that it is very dependable.

Senator Beaubien: Mr. Noiseux, there are both because we also have a sales tax throughout the province.

Mr. Noiseux: For the consumer.

Senator Flynn: Just for the purposes of the record. In the Cities and Towns Act of the Province of Quebec, the possibility is provided for imposing a 1 percent tax on the average value of a business house. This is the stop to the inventory for the average value of 1 percent. Obviously, it little matters what the result of the operations is; this can be very unfair.

Mr. Noiseux: That was mentioned earlier. There can be a big stop and the profits may be small. This is what happens.

The Chairman: Is there anything more, Mr. Noiseux, that you or your associates would like to say? Then, thank you very much. You have given us some very useful information.

The next submission is that of Mr. Edmund H. Peachey. Mr. Peachey is from Islington, Ontario, and he operates a number of businesses—Edmund Peachey Limited, Peachey Homes (Peel) Limited, Valhalla Inn Limited, and Bloor Lea Investments Limited.

Mr. Peachey, you have the floor. Will you identify yourself in relation to these areas, and tell us how the White Paper proposals affect your operations?

Mr. Edmund H. Peachey, President, Edmund Peachey Limited: Thank you, Mr. Chairman and gentlemen. As has been said, this will be a solo presentation—a sort of grassroots presentation—that will be a little different from the usual group presentations that you have been receiving. I speak on behalf of a small business that started small, and has grown to a medium size. I started with no capital, and I have brought these companies up by accumulating capital. So, it has been a sacrifice to get the working capital position correctly established.

I am the president of these four companies. They are more or less related, but they have different functions. There is no tax advantage in having the four companies. The main purpose in having them separated is not to have all of my eggs in one basket, and also to have management control and cash flow control, and all that sort of thing. It seems to work out better to have them separated, but there is no tax advantage at all that we can see, because we fill out these regular forms and allocate any profit to the companies as we see fit.

I am not really speaking so much on behalf of myself as for the youth coming up. The oncoming generation seems to be in jeopardy of being led into this political system where they become sort of automata, and are unable to effect their own future or life style.

This is not a lengthy brief, but I have tried to touch on certain cardinal principles which I think affect all small businesses, and which will certainly affect the youth who want to start in business for themselves. It is difficult for youth to start a business now because there are so many payroll deductions and it is hard to make a saving. The youth of today has a greater struggle than had my generation.

The Chairman: I think in paragraph 1 you indicate that the first two companies named are construction companies?

Mr. Peachey: Yes.

The Chairman: You say:

> Valhalla Inn Limited owns and operates a hostelry on Highway number 27 and Bloor Lea Investments owns and operates multiple housing on leased land.

Mr. Peachey: Yes, they own quite an acreage of land, and they lease the land. They

control the land, and develop the land for commercial or apartment users. It is developing slowly from time to time by adding another building or development.

The Chairman: You have developed all these businesses yourself?

Mr. Peachey: Yes.

The Chairman: Over what period of time?

Mr. Peachey: Well, I really started in 1930, you might say, but during the thirties we did not do very much. It was a matter of going to night school and learning the business, and working for a salary while carrying on the business—I suppose you would call it moonlighting now—as a sort of side issue. I was not able to leave my salaried employment in the thirties, because I did not have enough money, so what building was carried on was carried on at times before and after work. That is how we built up the business. We built it up by the slow process of accumulating savings.

The Chairman: And working hard.

Mr. Peachey: Yes, thank you. That is the background. When we read the White Paper we were kind of intrigued by the statement:

> The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity.

We just wonder why the word "seriously" was put in there. If the word seriously was omitted then we would like it a lot better because it would then read:

> The second main objective of tax reform is to see that the tax system does not interfere with economic growth and productivity.

I do not know what they mean by the word "seriously", but it is a key word in that paragraph.

If you have a serious injury and are in hospital then perhaps you are in danger of losing your life. I am wondering if that is the sense in which that word is used.

Senator Phillips (Rigaud): They probably meant that the patient should not yell too loudly.

Mr. Peachey: Yes, that is a good explanation.

The Chairman: Perhaps it means that you are so sick that you have not any yell left.

Mr. Peachey: That is more to the point.

The philosophy stated here is that in our particular corporations we have reached the point where we do not compete with the small unincorporated builder who has no overhead. We do have overhead. We have to keep a certain staff und operation going even though we do not have any revenue. In other words, we have a fixed overhead.

We do welcome the plan of the authors of the White Paper—this seems to be a great step forward—because they are willing to recognize the need to eliminate the double taxation of corporate income after taxation.

The White Paper gives small business the partnership option in the case of personal rates, and in looking them over we feel that these three provisions are going to restrict the use of this partnership option. We think that the partnership option is a good thing. You could have an account set up presumably in your books, and that would be the partnership option account, and the money that would be paid out to the share holders would come back to the company, and that is what you need. The problem is to retain enough working capital to be able to expand and keep the business going as salaries, material costs, municipal taxes, and all the rest keep increasing, and then we have to keep a reserve for reverses. We are constantly trying to build up working capital, and we have never yet paid a dividend on our working capital. We have not been able to do that because there is a need for renovation and expansion. If you do not expand, you fall by the wayside.

We like the partnership option, but we think there will be difficulties in getting all the shareholders to consent. There might be a situation in which one would not agree. A shareholder might have to leave the country. It eliminates any participating and non-voting stock plan, which is a nice plan to have in some companies because it gives your management staff some incentive. Unless these restrictions are liberalized, most closely-held companies will be obliged to retain earnings, and probably pay out stock dividends.

Senator Aseltine: Do you say it would be impossible, on account of the number of shareholders in these closely-held corporations, to obtain their consent?

Mr. Peachey: Not impossible, but in some cases it would be difficult.

The Chairman: I think that what Mr. Peachey means is that is would be difficult

having regard to the different interests or the different intentions that different shareholders might have.

Mr. Peachey: As shareholders get older, their interests diverge, and they get into other lines of business, and perahps they are not so interested.

The Chairman: But you have to get the consent of all before you qualify?

Mr. Peachey: Yes, according to the White Paper, and that is a difficulty.

The Chairman: Even if you have to leave the country on account of ill health.

Mr. Peachey: Yes, as far as I can make out there are no exceptions made in connection with these partnership options. It is a sort of fixed plan, according to the way I read it.

However, the White Paper recognizes the need for holding earned surplus in the company. That is vital to all these companies that are growing and developing, and we cannot see any reason why that could not be to a special allocated surplus account. It could be considered a return of capital to the shareholders and placed in that special account. That would solve a lot of problems of integration and so on. We cannot see that the effect on taxes would be any different, because under the White Paper they are prepared to give small businesses the partnership option of the tax paid under the distributed income, and we think that that would be a suggestion that should be explored.

Senator Phillips (Rigaud): I don't follow you. If you segregate it, is it your thought that it would then be taxable in the shareholders only upon distribution?

Mr. Peachey: If we took the partnership option, so far as I can make out, and set up a special account, a partnership option account then in theory you would pay the money to the shareholders and they would put it back into the company.

Senator Phillips (Rigaud): That is on the partnership option, but what would happen in the case of corporations?

Mr. Peachey: That is what I am talking about. The closely-held corporation is entitled under the White Paper to do that.

Senator Phillips (Rigaud): Yes, but what would happen when you segregate the surplus thereafter?

Mr. Peachey: It would be retained earnings in the company. It would be used for equipment and buildings and so on.

Senator Phillips (Rigaud): It would be taxable on distribution.

Mr. Peachey: You mean on liquidation of the company?

Senator Phillips (Rigaud): No, on distribution to shareholders during the lifetime of the corporation.

Mr. Peachey: As I understand it under the partnership option, while you can retain the money in the company it is also capital in the hands of the shareholders.

The Chairman: It is a fiction.

Mr. Peachey: It is a kind of fiction, yes. And the same with the stock dividends. If you pay a stock dividend, the shareholders get the additional stock. Presumably they can cash it if the company is able to do it at any time.

Senator Phillips (Rigaud): You think that is more advantageous to shareholders of a small company than the low rate of taxation up to $35,000 and the 20 per cent tax credit with possibly an increase in that percentage?

Mr. Peachey: We think it is much more vital. We figure the $35,000 low rate is worth about $10,000.

The Chairman: That is right.

Mr. Peachey: We feel when you are growing that that is not so important. For these reasons we feel that very small companies that are earning less than $35,000 might have some arrangement made whereby you would allow then some additional expense on their accounts. There might be some way of having an extra or special expense allowed to the company to couteract that. The way it is now the small business don't pay too much tax because they cannot afford to and they simply find ways and means of offsetting the tax from year to year. We thought probably if you wanted to help small businessmen, because there seems to be so much abuse of the $35,000 low rate in the large corporations, why not look at the little fellow who has earned less profit than $35,000 and give him some extra or special expense accounts. I am not an accountant, but there must be ways and means of doing that.

The Chairman: Are you suggesting an expense account just to see to it that earnings

or income of the company are increased? Do you mean a fictional item?

Mr. Peachey: No. When we get a field order from the Department of National Defence the department makes a pretty rigid inspection of all expenses and quite often they disallow some. In the case of the small businessman perhaps some more liberal approach could be adopted.

The Chairman: Two of your companies are in the construction business. Therefore, they may have the right to take some depreciation or some capital cost allowances.

Mr. Peachey: That is true.

The Chairman: Another of your companies operates a motel.

Mr. Peachey: Yes.

The Chairman: The Valhalla. It would have depreciable assets which it could write off?

Mr. Peachey: That is true.

The Chairman: But that is because of the nature of your business. The opportunity is available to increase capital cost allowance so far as that type of business is concerned, but capital cost allowance would not do if you were looking for a general rule. You were here when we heard the hardware people. Their money is mainly tied up in inventory so that capital cost allowances would be of very little value to them.

Mr. Peachey: There is a big argument or controversy about inventories—how much can you write off and so on. I thought perhaps that would be one item where you could allow a little higher write-off in a company in the small business range.

The Chairman: We are looking for all these suggestions, but I find it difficult at the moment to assimilate one that would apply to each business, because we could not generate a rule of fairly general application without imposing on the tax authorities the obligation to study the inventory of each company and its depreciable asset position, which, in effect, would necessitate a set of almost individual rules. That would really cause enormous difficulties in administration.

Mr. Peachey: You may have a point there. I am not pressing it.

Senator Everett: Mr. Peachey, I gather that you are in favour of the concept of a single rate of tax.

Mr. Peachey: Yes.

Senator Everett: However it is achieved. Is that correct?

Mr. Peachey: Yes. We are in favour of that if a White Paper plan of closely-held companies is adopted which allows us to retain the earnings in the company. In other words, we would eliminate the double taxation which now exists. The way it is now you pay 50 per cent and there is the problem of the balance of the earned surplus, as we call it, being taxable either by dividend or by some other method. That has led to the so-called dividend stripping. But the White Paper, so far as we can make out, agrees that in closely-held companies the shareholders can put the money back into the companies and it is capital in their hands. It can be drawn out in some form in the future. We think that is a most important thing. If the closely-held businesses have that, we would be willing to waive the $35,000 low rate.

Senator Everett: Let me suggest that they might well be mutually exclusive principles. The White Paper is not necessarily talking of a trade between those two things.

Mr. Peachey: No, I know.

Senator Everett: Would you be in favour of the concept you have just spoken of and a rule such as was discussed here earlier of a low rate of tax for those small companies that need the low rate of tax but which is not available to larger companies?

Mr. Peachey: I would be in favour of that, yes.

The Chairman: Senator, actually what you are saying is that it could be optional. In other words, a small business might take the 21 per cent or it might take the partnership method. If you gave them the option you would cover Mr. Peachey's point, wouldn't you, and the option he would elect would be the partnership option, I assume?

Senator Everett: I don't know that Mr. Peachey is necessarily discussing an option. He says that the single rate of taxation, the single imposition of taxation in his case, is so important to him that he would trade off the low rate of tax. But he is not necessarily saying that such a trade-off is necessary.

Mr. Peachey: Yes, that is about it.

The Chairman: No, he is expressing a choice.

Senator Everett: But, if he has to make a choice, he is prepared to give up the low rate of tax.

The Chairman: What I say is, if it is on an optional basis, you can take one or the other. He can make his choice but he is not shutting somebody else out. Somebody else might prefer the 21 per cent.

Senator Everett: I had not thought of the implications of that, but it is certainly worth investigation.

Senator Phillips (Rigaud): I don't think we have quite pursued that point, Mr. Chairman.

The Chairman: I have been thinking about it.

Senator Phillips (Rigaud): I am just pausing to note that an optional privilege could be given to the taxpayer to avail himself of the lower rate, say, up to $35,000 or alternatively to be taxed on a partnership basis.

The Chairman: I would be inclined to remove that restriction that all the shareholders must agree or that option is not available. I do not see any difficulty in administering it. The willing shareholders will be a certain percentage and you can deal with it in that way.

Senator Phillips (Rigaud): Would you extend the optional privilege if we extended the special rate of taxation escalated from 35 to 75?

The Chairman: I do not think you can do that. I think the special rate with the "nots" provision would have to apply in the case of those who elect to take the lower rate. That is part of it. You move them up to a certain rate and then they are paying the full rate. That is one choice. The other choice would be to treat it as a partnership without requiring 100 per cent of the shareholders to be in agreement.

Senator Aseltine: The majority would rule in that case?

The Chairman: Either a majority or those who wish the partnership basis representing a certain percentage of the shareholders and a certain percentage of the net profit. They could be treated on that basis because it does not involve taking the money out of the company actually. It is a fiction.

Senator Aseltine: They take it out and put it back in again.

The Chairman: Well, you can do that, but as I read the White Paper, I do not think you would even have to do that. Here is a fiction. You just transfer it into a special account. That is how I read it. After all, if you are writing the law, Parliament can say what it wants to say as long as Parliament approves.

Senator Molson: Mr. Chairman, is not this one place where we are running into the problem that the individual parts of the White Paper are difficult to segregate from the whole, in talking of the treatment of this one incident which is perhaps dependent on what else is in the White Paper and what is left or amended.

The Chairman: You are quite right, senator. As we have been discussing it, you have the pillar which is the grossing up and the integration. Now there are quite a number of elements that go into that. There is the capital gains tax and if you take that and make it a separate tax so that it does not go into the income part, you have taken quite a prop from the grossing up and integration of income. Then if you strike out the deemed realization, you have taken another prop because what the White Paper says in the clearest language possible is that on the capital gains tax which they are proposing which is part of the grossing up and integration, we may have the effect of locking in shareholders rather than having them wish to sell and pay the amount of tax. And this was the point that Richardson Securities made the last time they were here, and that is why they recommended a 15 per cent tax instead of 25 per cent because they said that people who have their money invested in growth industries and the stock has gone up, ordinarily they might say "Well, I am going to leave that to the investors now, and I am going to take my money and start this routine again from the low level up." Now for 15 per cent, they might be prepared to do that, but for 25 per cent, they might be prepared to stay with it. So, along comes the deemed realization, as the White Paper says, to unlock them at 50 per cent. And it is a compulsory unlocking.

Senator Phillips (Rigaud): Is it not a fact, Mr. Chairman, that as you said the integration concept being the hard core, you separate it there from the treatment of capital gains in all its ramifications and the treatment of small businesses.

The Chairman: The closely-held corporations.

Senator Phillips (Rigaud): And closely-held corporations. In a sense the other briefs we have listened to, dealing with natural resources fundamentally, deal with an entirely different point.

The Chairman: That is right. So the pillar that has all these essential props supporting it, if you take a number of them away, ceases to be a supportable pillar.

Senator Molson: Another thing in that connection just to follow on what you have already said, I think it would also mean that the top rate of 50 per cent for income tax as suggested would no longer be the valid maximum very likely.

The Chairman: That is right, because then there is the other element as well.

Senator Molson: It falls down with the principle of integration.

The Chairman: Well, there is this, the 50 per cent rate for personal income which was suggested is realizable to the full extent in five years, not immediately. But if you are going to become subject to capital gains tax in the meantime, under the White Paper, you are going to pay whatever your marginal rate is, which is somewhere between 82 per cent and 50 per cent. Yet the tabular calculations are made on that 50 per cent that you may get in five years, unless they find they need more money. And there is no guarantee that you will get it in five years.

Senator Phillips (Rigaud): And Mr. Chairman, you have biblical proof of the precedent that prophesies are not always fulfilled.

The Chairman: Sometimes it takes a long time to fulfil them.

Senator Phillips (Rigaud): We are still waiting for some of them.

Mr. Peachey: Continuing with this system of tax-paid earned surplus, we notice that in starting the system, there is a payment of a flat rate of 15 per cent on tax-paid earned surplus already accumulated in a closely-held company. Now this is an improvement over the requirements in the existing Income Tax Act, but it would require a substantial dissipation of the company's working capital to do that. In the case of one of our companies that we have coming along it would be about $60,000, and that is a lot of money to take out. We think that seeing that the valuation day is forgiving all capital gain up to that point, we think the White Paper should forgive tax-paid earned surplus at the same time. The same principle seems to hold, in our opinion. Why should they be charged 15 per cent on this earned surplus that they have already accumulated in a hard way over many years?

The Chairman: Except if they wanted to take it out now, they would have to pay 15 per cent.

Mr. Peachey: That is what they would have to do. Anything in the future would be designated surplus. It would be separated apparently from the oncoming surplus.

The Chairman: What you are suggesting might be involved then is the designated surplus as we know it in the Income Tax Act now which is based on a change of ownership. The surplus is locked in.

Senator Molson: You think that valuation day should provide a completely fresh start?

Mr. Peachey: Exactly.

Senator Molson: A point of departure?

Mr. Peachey: If it applies to capital gains, why could it not apply here? Why does it not apply to corporations just as it applies to individuals?

The Chairman: You say that whatever the earned surplus may be on valuation day—and it should be easy to value at so many dollars even though it may be in bricks and mortar—you say that that is clear.

Mr. Peachey: Allocated surplus.

The Chairman: It does not attract any of the incidents of the White Paper proposals.

Mr. Peachey: We recommend that, gentlemen, as a good move to see that the tax system is carried out honestly.

Senator Molson: You have paid your normal tax up to this point.

The Chairman: But if you have an accumulated surplus that goes back over a period of years?

Senator Molson: But they have not had a bash at the shareholders' portion of that.

Senator Carter: But does that not become retroactive taxation?

The Chairman: It does. That is the effect of it. And the Senate has had the reputation up

to this moment of only approving beneficial retroactive legislation.

Mr. Peachey: Well, gentlemen, we hope that you will give that some attention.

Senator Everett: I have a question which may be probing too far into personal matters. If it is, I hope you won't answer it. Far down the page, and we will be coming to it, you have a statement of your personal holding companies.

Mr. Peachey: Yes.

The Chairman: Is this on page 4?

Senator Everett: Yes. This is not terribly germane. I do not know what your age is, but I assume you are concerned about estate taxes at some point.

Mr. Peachey: Yes.

Senator Everett: And yet you have not chosen to strip surplus.

Mr. Peachey: No.

Senator Everett: Or you do not appear to have.

Mr. Peachey: No, we have not stripped surplus.

Senator Everett: Could you tell us why? As I say, you do not have to answer if it cuts too close.

Mr. Peachey: We are sort of abiding by the tax laws and, as far as I know, that is not in accordance with the present tax laws. We have never been given any method. We know that companies have tried various methods, but we do not know of any legal method whereby that can be done and, therefore we have not done it.

The Chairman: Maybe you should get some more advice.

Senator Molson: Well, good advice.

The Chairman: Yes.

Mr. Peachey: We notice in the press that there has been a lot of talk about discrimination between closely-held and widely-held corporations. We think the distinction in the White Paper is well taken. We think there is no doubt a clearly marked difference. A closely-held company is dependent upon its own resources and credit, and the shareholders are actually the company and they cannot pass on the corporation tax to consumers the same way as a widely-held corporation does. They have a constant problem of working capital shortage. It is a constant problem, what do you do with the certain amount of working capital you have.

The Chairman: Mr. Peachey, if you stopped right there, what you are doing is talking to your definition of a closely-held company. It sounds very much in terms of the type of operation that you have.

Mr. Peachey: Exactly.

The Chairman: But, remember, under the White Paper a closely-held corporation would even be the T. Eaton Company.

Mr. Peachey: Yes, but it still applies to the T. Eaton Company in some respects. I know they are a big company, but that is the common idea put across. If they went public, presumably they could have a big bonanza at that time and presumably they would draw in a tremendous amount of capital from the public.

The Chairman: I am not talking about them going public; that is their own decision. I am talking about the competitive position of a number of corporations operating in the same field, and the distinction that is made for tax purposes and the benefits that result therefrom, as between closely-held and widely-held. It strikes me as being fictional.

Mr. Peachey: Do you not think the competitors of the T. Eaton Company are in a better way financially? They can have large stock issues and can issue debentures and bonds, and various things, things which the T. Eaton Company have to do within their own organization. They cannot get any public money, but they can get loans, and so on.

The Chairman: There is no prohibition on a closely-held company borrowing money.

Mr. Peachey: But they cannot go to the stock market. Most companies I know of that have gone public have immediately got a huge source of capital from their stock issue.

Senator Molson: Very often it is not the company but the individual shareholders who get the money out of the market.

Mr. Peachey: It may be.

Senator Molson: It is almost invariably so I would suggest to you. It is not the company that as a rule benefits, but the previous share-

holders who go public and sell a portion of their interest to the public, and get the cash.

Senator Everett: Dealing with the T. Eaton Company situation, Mr. Peachey, would it be your feeling that this type of situation is a very special one that might be dealt with in another manner entirely?

Mr. Peachey: It is pretty difficult for me to talk about those companies. I think there has to be some simplicity in this tax system. I do not think you can take care of every exception and point to one thing and say, "Because of those two or three companies, discrimination exists." The essential ingredient of a tax system, as I mention later on, is some sort of simplicity. Right now you have to spend almost all your days trying to understand it.

Senator Beaubien: This is the White Paper you are talking about?

Mr. Peachey: Yes, but even previously.

Senator Beaubien: The law as it is now?

Mr. Peachey: Yes.

Senator Everett: You are saying it should not fall apart just because there are a few "T. Eatons"?

Mr. Peachey: Yes, that is right, because if we lose 100 per cent credit, I am sure the widely-held corporation will not get it, so we worsen our position, with no benefit to them, as I see it.

Senator Molson: Just to follow through what you said a minute ago, the present system is extraordinarily difficult and complex, and we know that and accept it.

Mr. Peachey: Yes.

Senator Molson: But do you think the White Paper, with respect to that aspect of your making you returns and calculating your tax, would simplify matters for you?

Mr. Peachey: I think it is more straight forward now as to this particular item.

Senator Molson: No, I am not talking about the item, but the full implications of the complexity.

Mr. Peachey: Do you mean the White Paper stacked on top of the present law?

Senator Molson: Substituted for the present law.

Mr. Peachey: I think it would be very difficult right now. I erroneously calculated the next item in the first place. Even while studying the White Paper, I came to the incorrect conclusion, so I had to get my accountant to make up this summary of my position.

Senator Molson: Do you think it would be more difficult to make the returns as proposed?

Mr. Peachey: I think so, undoubtedly.

Senator Everett: Do you have your accountant with you, Mr. Peachey?

Mr. Peachey: No, I was thinking of doing that, but I thought you gentlemen had probably been listening to a great many accountants and perhaps you would prefer to hear somebody who is not in that category.

The Chairman: You guessed right.

Senator Molson: You are not a lawyer, are you, Mr. Peachey?

Mr. Peachey: I have divulged here the position of Edmund H. Peachey Limited. It is not very active at the moment, and is more or less in the position of a holding company. I have had my accountant work the thing out, according to the White Paper and according to the present estate tax. This statement is based on the assumption of the sale of the shares of Valhalla 10 years hence—in other words, on the death of the principal shareholder. Therefore, we are paying $615,000 capital gains, and if you follow through there you will see that the death tax and the estate tax require $1,170,000, and the tax, including the land tax and corporation and capital gains tax is $790,700. If you turn over to page 5, this gives you the position of the company: cash received after liquidation, less the 15 per cent I was talking about previously on retained earnings on hand, and the death taxes payable. Out of this company which is valued in 10 years hence at $2,350,000 there is a $316,400 left. That is a disastrous situation. No company can survive under those conditions. My accountant went to the trouble on the next page of trying to calculate the White Paper's apparente concession that the shareholders can postpone the capital gain. But if you look at these figures you will find that the shareholders are not able to do that.

The Chairman: They would not have enough money.

Mr. Peachey: No, there would not be enough money, so they have to sell the

shares. If they do not sell the shares they would only have $871,400 available to pay death taxes of $1,170,000, so they would have a shortage.

The Chairman: Having sold, the capital gains tax would be payable on that forced sale?

Mr. Peachey: That is right, so as far as we are concerned this is an absolutely impossible situation. In my first submission I sent in a theoretical situation. This is an actual situation, and it is not any different, as far as I know, from any other company. Most companies have probably not gone to the trouble of making out a stated case. I think that if they are going to put a capital gains tax on, it has to be deemed as occurring at death, the capital gain deemed occurring at death, and the estate tax must be wiped out. You gentlemen have to take a strong stand on that.

Senator Phillips (Rigaud): Would you accept the comfort from this committee that we have examined a high official of government, who said that in the crisis you have just pinpointed the banking system would provide you with the money at a high rate of interest by way of a loan.

Mr. Peachey: I realize that.

Senator Beaubien: You have got no equity, though.

Mr. Peachey: As a matter of fact, when the estate tax was put in I asked Mr. Benson if they would not consider this: if the beneficiaries of a privately held company, own at least 15 to 20 per cent of the capital stock leave it in the private company for ten years, would there be some exemption or some waiving of the estate tax? But all they did was say they would give a postponement of five years to pay it at the standard rate decided by the minister, so I doubt whether it is much of an advantage.

The Chairman: Plus interest.

Mr. Peachey: Yes, plus interest. I hope you gentlemen follow that.

The Chairman: Yes, we follow that.

Senator Everett: I should like to ask some questions on the balance sheet. On the assets side of the balance sheet, at the top of page 4 you show Valhalla Inn, and then two figures of $260,000 and $40,000.

Mr. Peachey: The $260,000 is preferred stock, which is at fixed value, and the $40,000 is common stock.

Senator Everett: When the sale takes place, I gather what you sell is the land, which has a book value of $148,600. Is that correct?

Mr. Peachey: That is correct.

Senator Everett: Plus Valhalla Inn. What do you sell?

Mr. Peachey: In that case we are talking of selling common shares.

Senator Everett: $40,000 common?

Mr. Peachey: Yes.

Senator Everett: At the bottom of the page, which is the balance sheet as it would appear after the sale, you show other assets of $470,600.

Mr. Peachey: That is the addition of these items—the fixed assets, the preferred stock. I have them here. There are $150,000 preferred shares in Peachey Homes (Peel) Ltd., $260,000 preferred shares in Valhalla Inn, and there is $44,600 of other assets, with $16,000 fixed assets.

Senator Everett: So that is taking out the $148,600 in land and the $40,000?

Mr. Peachey: Yes. That totals $470,600.

Senator Everett: In the middle of the page you say: "Less value at purchase date of Valuation day:—$148,600 for land and, say $270,000 for common shares of Valhalla".

Mr. Peachey: Yes.

Senator Everett: Is that a fair figure?

Mr. Peachey: We had a valuation scheme worked out by auditors and accepted by the department. That is a pretty good figure.

Senator Everett: And if valuation day were today?

Mr. Peachey: I do not know when valuation day will be. I assume valuation day is roughly now, but it could be a little more by the time valuation day comes along.

Senator Everett: There is no increase in the value of the land?

Mr. Peachey: Not in this study, no. This land is sort of sterilized by re-zoning propositions, and it cannot go ahead until a lot of

other land is developed. It is more or less in a state of limbo right now.

The Chairman: If the White Paper goes through on this point, that may be disastrous for you.

Mr. Peachey: It could be.

The Chairman: If you get a low value on valuation day and then there is re-zoning.

Mr. Peachey: That is one of the problems.

Senator Everett: You value it at $148,600, plus $270,000.

Mr. Peachey: Yes.

Senator Everett: That is $418,600?

Mr. Peachey: Yes.

Senator Everett: Where do you get the $2 million sale price?

Mr. Peachey: This is ten years hence. This is an assumption, mind you. We take it that the land will be much more valuable. We have figured out the valuation. The land, we figured, would be worth $500,000 then. No, that is wrong; the valuation of the land we have got as $500,000 and the stock $270,000. I misread that. This is less value at purchase date on valuation day. The valuation in this set-up is that we value the land at $500,000. The total is $770,000.

Senator Everett: Where does that show?

Mr. Peachey: It does not really show here. We subtract $500,000 and $270,000 from the $2 million figure.

Senator Everett: Your calculation then would be $2 million.

Mr. Peachey: Less $770,000, yes.

Senator Everett: Less $148,000?

Mr. Peachey: No, that is already included in the valuation. If you take $770,000 from the $2 million...

Senator Everett: The $770,000 is the valuation of the land and Valhalla?

Mr. Peachey: That is right.

Senator Everett: Is that how you arrive at the $615,000 creditable tax?

Mr. Peachey: Yes. Double that would be the difference.

22007—3½

Senator Everett: Would you do that calculation for us?

Mr. Peachey: If I subtract the $770,000 from the $2 million...

Senator Everett: That is $1,230,000. Then 15 per cent...

Mr. Peachey: If you take $770,000 from $2 million you get $1,230,000; if you cut that in half it is $615,000, and that is creditable tax, less that capital gain. We are paying $615,000 capital gain, but, you see, the rest of the land taxes we would have to pay in any case.

Senator Everett: Really what you are saying there is, you are taking the sale price of the land less its book value.

Mr. Peachey: That is right. We have to take the book value because that has already been paid.

Senator Everett: You are assuming that the book value is $270,000.

Mr. Peachey: The value of the shares in Valhalla Inj we have already calculated. We had a calculation made of that.

Senator Everett: Would you not have to deduct the book value in order to arrive at the amount subject to tax?

Mr. Peachey: The book value is very nominal. You could, but it is nominal.

Senator Everett: You are talking about estate taxes here?

Mr. Peachey: That is right.

Senator Everett: You receive $2 million for the land and the shares?

Mr. Peachey: Yes.

Senator Everett: You are entitled to deduct from that you book value, are you not?

Mr. Peachey: In a sense it is included in this $270,000. Actually the shares of Valhalla Inn were valued at $230,000 right now, so we have added the $40,000 on to that to get the $270,000; it is already in there. We have increased the value by $40,000 just to take care of the $1 value of the shares in the books. In the books of Peachey Ltd. these 40,000 shares are valued at $1, or $40,000. So we have added that to the value of the Valhalla shares at this time, $230,000, making it $270,000. It is included there.

Senator Everett: We see how you arrive at the creditable allowance of $615,000, but going on to page 6 and dealing with that portion of the White Paper that permits you to add to the value of your shares the amount of capital gains tax paid, you would reduce the estate tax liability by how much?

Mr. Peachey: I do not think that really enters into it.

Senator Everett: Presumably it does, because in the first instance you show an estate tax of $1,170,000, plus a tax on the realization of the assets, showing a total tax liability of $2,030,000.

On page 6 you take a credit for the gains tax, as I understand it, and add it to the value of your shares.

Mr. Peachey: No, I must admit that this paragraph in the White Paper, 3.42, is nebulous as far as I am concerned. However, this is my accountant's interpretation of it. Actually it works out so that the tax refund is the same as the capital gain.

I must say that I myself have difficulty in interpreting this in the light of paragraph 3.42 in the White Paper, but this is the way my accountant interpreted the refund that would ve available if a capital gain were not taken at the point of death. If you postpone the capital gains tax, his interpretation of this paragraph would mean this. I am not quite sure that that is what is meant. It is not clear to me, but it is a possibility.

In any case, it does not really apply here, because we would not have enough money to pay the death tax in any case. Therefore we could not take this refund and the estate would have to pay the capital gains tax in order to get enough money to pay the death taxes.

Senator Everett: But he says at the top of page 6:

> However, it would appear from para. 3.42, that the government proposes to postpone part of it to be paid later by the beneficiaries should they decide they are compelled to dispose of the remaining assets.

Mr. Peachey: Should they decide to, but in this case they would have no choice, because they have not enough money to pay the taxes.

If I take off the $615,000, they have only $871,400 available to pay tax of $1,170,00. There is a shortage there.

Page 6 is really an exercise in futility, because the estate has to obtain the money to pay the death taxes. The capital gains tax makes it absolutely disastrous.

The Chairman: Senator Everett, do you not think that whether the calculations are accurately worked out or not they do demonstrate the disaster that would follow from this eventuality?

Senator Everett: That is true, Mr. Chairman. I would like to follow through with Mr. Peachey how he arrives at these figures.

I stated, I think erroneously, that the amount of capital gains tax was added to the value for estate purposes. I think it is the other way around: the amount of estate taxes is added to the value of capital gains taxes.

Mr. Peachey: You are referring to page 6?

Senator Everett: Yes.

Mr. Peachey: The same figures appear here and they work back to the tax refund, which is the amount of capital gains tax. Therefore I though they were accurate.

He does assume that 90 per cent of the estate is shares, which would probably be true.

Senator Phillips (Rigaud): Mr. Peachey, as a lawyer I have one defence to your problem, which I am giving you free. Under no circumstances become an estate. I think that is your only solution.

Mr. Peachey: No, I think the solution is that if the deemed valuation of capital gains should occur at death, they have the capital gains tax. However, the estate tax should be dropped.

There are many people in favour of it. That is the only way it can be done. I wish you gentlemen would urge that.

The Chairman: We have noted it, Mr. Peachey. You are not the first to say it.

Senator Everett: I wish to make one point for the record. The result of the calculation on page 6 is covered at the top of page 7, which says in effect that your auditor's appreciation of the effect of paragraph 3.42 is the following:

> If this analysis is correct, it may be that the Estate would be left with a balance of $931,000.

Which is an increase over the situation, if it is not correct, from $316,000.

Mr. Peachey: Yes. Since I have written that I have made some calculations and I realize that there was not enough money in the estate to carry out the postponement. If we could postpone the capital gains tax and did not have to pay the death tax, there would be apparently $931,000 there.

Senator Everett: I would differ with you, because your auditor goes on to say:

> This is dependent upon finding a buyer with the necessary cash and interest to pay the full market value.

He is comtemplating the sale of the estate.

Mr. Peachey: That is right.

The Chairman: But not guaranteeing the realization.

Senator Everett: But if paragraph 3.42 is operative, the amount retained increases from $316,400 to $931,000.

Mr. Peachey: If it can be worked out in some manner, yes.

The Chairman: If you can sell at the price.

Senator Everett: Yes, that is right, if at the fair market price and if paragraph 3.42 is operative. However, one of the things that this committee will be concerned about is whether or not paragraph 3.42 does operate in the manner indicated by Mr. Peachey's auditor.

The Chairman: That is right.

Mr. Peachey: Yes, but if it works in that manner I am still short. When I pay the capital gains tax I receive $615,000 credit, because the other part goes to tax.

Senator Everett: That is right.

Mr. Peachey: If I now have the money in the estate to pay the death tax of $1,307,000, do not sell the assets and land of Valhalla Inn Limited and do not take the capital gains, I lose $615,000. I do not receive that, therefore, the cash I have is only $817,400 so I am short $250,000 roughly.

The Chairman: Mr. Peachey, I think we have shaken this one around and there are a number of ifs in it.

Mr. Peachey: If you would like I will send you a resumé of this sheet.

Senator Everett: It would be very useful.

Senator Aseltine: In any event, it looks like confiscation to me.

Mr. Peachey: It is pretty close to it. Even at 40 per cent it is pretty difficult to operate a company.

The Chairman: We are now on page 7. You talk about the impact of capital gains on the home building market.

Senator Everett: I wonder if I could come back and deal with earlier pages. You say on page 3 that you wish to replace the involved techniques of credit for tax, stock dividends, and the two-and-a-half year limit, with a system which allows closely-held companies to set up tax-paid distributed income, as recommended by the Carter Commission. Could you give us the rough details.

Mr. Peachey: I thought I already mentioned that. Instead of fictional credits for tax and partnership options. If you could set up an account which would be allocated surplus.

Senator Everett: That is what you were dealing with.

Mr. Peachey: That is what I meant.

The Chairman: On page 7 you are dealing with the impact of capital gains on the home building market, and this is a question that has been discussed many times before us. That is the proposal to have tax on principal residences.

Mr. Peachey: I think this is an idea which Mr. Benson has mentioned several times in the past. He is worried about the man who has a valuable corner and gets a big bonanza because he happened to be located in a rezoned area. It is unfair to have all of the homeowners in Canada keeping all of these records. I have to keep track of all my expenses for even such things as postage stamps and vouchers. I think it is ridiculous to ask this of those who comprise the backbone of the Canadian economy, just because the odd joe makes a big gain on some corner. If you happen to go to the races and get a 300 to one shot and win $50, I feel it is a once in a life-time windfall. The Government can surely forget about these things. They are getting too petty and interested in every little step you make, and I do not feel that it is necessary. It is only one-half of one per cent of all the homeowners of Canada who reach that area.

The Chairman: You talk about the proposed exemption of $500 on personal belong-

ings. You must have been listening in or reading over my shoulder at the last meeting, because I read into the record an opinion of Mr. Ben Ward-Price who said exactly the same thing, that the $500 should be $5,000.

Mr. Peachey: I do not see why the tax department wants to spend all that money in going into small items. As far as I know all of the great paintings have been bought. It is pretty difficult to make large gain on a painting today.

The Chairman: You speak of entertainment and related expenses.

Mr. Peachey: Of course, we are running a hotel and we see that different companies have different ways of handling expense accounts. We certainly have no yachts or hunting lodges, but I suppose that if a person is selling his ship or a computer there is some justification. Coming back to the Carter Report I read about one case in which all expenditures reasonably related to gaining or producing of income should be deductible.

The Chairman: You subscribe to that.

Mr. Peachey: Yes, I think so. In Table 16 they said that they were going to get $5 million from this extra drive on expenses. In my opinion that does not seem to be very much.

They might leave business alone, because you have got to have personal relations. You must make a decent sale and sometimes this is done over lunch or dinner. I did not consider the matter of hockey tickets, because that has already been discussed.

The Chairman: What is under this heading "Complexity".

Mr. Peachey: I would like to show you. I have brought the forms with me, because pictures speak better than words. Here is a tax form from the year 1925 and that is all we had. Here is the one we used for 15 years, and it is just a four-page form which seems to have been sufficient. The one I am showing you now is all small print and contains six copies. I think we should be turning the clock back a little bit, and simplify it.

Let me read what they have done in the United States about the new tax form. This is from the Kiplinger Washington Letter dated April 10, 1970:

> The real foul-up in federal income tax returns is just starting, now that they are flooding in and the Treasury is checking into them. More mistakes than ever have been made in filling out returns. Not intentional evasion, but errors in interpreting the rules. In more cases, taxpayers will be asked to correct their returns. Many refunds will be delayed for months due to the confusion.
>
> Behind the confusion is the new 1040 form...

And it goes on to say

> But for now, this year...fewer returns will be audited closely, because the Revenue Service people who would normally handle this chore are busy checking on trivial matters that result from the current mess.

That gives you an idea. They had a reasonably simple form and now they have gone into this White Paper business and have bogged down. It says that there is no relief for next year.

> ...next year it will be just as bad. True, Government tax men say that they are going to straighten out the confusion and ambiguities in the 1040 form as it stands, but—there are changes in the tax laws to be reflected in the 1040 next year.

It is more complicated. Some of us have got to revise this tendency to make things more complicated.

The Chairman: You made your point, Mr. Peachey.

Mr. Peachey: All right.

The Chairman: The next item you want to talk about is under the heading suggestion. Under the first one I notice that you talk about grants to provincial governments.

Mr. Peachey: The other major point is that we have a tax reform system for five years, and I see nothing in the White Paper at all about how the money is going to be spent. It seems to me that spending reform is a vital matter in Canada and I have offered a few suggestions.

I feel that all of us should get together with the provincial members and the federal members, and that there should be some clear-cut definition of tax source. The Carter Report suggests that the sales tax should go to departments and the income tax to the federal government. An example of the simplest form was the Ontario gasoline tax. You knew that when you paid gasoline tax that it went toward the paving of the roads or inter-

changes. If you wanted faster highways you paid more gas tax, and if you did not want them you paid less. That is a very simple and primitive idea of how the tax law should be. The public should know how they stand without having to go through this mass of paper, and the welfare should know because there are so many expenditures to pull out of this consolidated revenue fund. We have no control. You only have to look back to the jet-liner, radio, the hydrofoil which is still lying in a harbor...

Senator Aseltine: We call it education tax in Saskatchewan.

Mr. Peachey: They are building up the consumers department for consumers affairs. With all the money we are spending on education surely the consumers are better able to take care of their own affairs. There are three or four thousand employees in that department. It seems to be a tremendous proliferation of tax. There is no reason why we should not have this cost-benefit analysis. I think we should have a five-year revenue forecast and I feel that this budget is very important. We have been reading the horrible stories in the *Globe and Mail* and I feel that every year somebody should be going back to each program and looking at to see if we can spend the money to better advantage. I have not seen that item mentioned at all in these hearings.

The Chairman: But it has been.

Mr. Peachey: It has been? That is good. I think that is one thing we have to do to make sure that the tax money is better controlled than is shown in the horrible stories which we see every day in the *Globe & Mail*. Thank you very much, Mr. Chairman.

The Chairman: Thank you, Mr. Peachey.

The Chairman: We now have two other briefs, that of the Montreal Museum of Fine Arts and the brief from the Canadian Art Museums Directors' Organization. I understand those two briefs are, in a sense, going to be presented together. To present those briefs we have with us Mr. Charles Gonthier, Mr. David G. Carter and Mr. Sean Murphy. I will now ask Mr. Gonthier to start.

Mr. Charles Gonthier, Honorary Secretary, Montreal Museum of Fine Arts: I am Charles Gonthier and I am Honorary Secretary of the Montreal Museum of Fine Arts. The brief for the museum will be presented by Dr. Sean Murphy, who is seated to my far right. Mr. Carter is the Director of the Montreal Museum of Fine Arts and is also President of the Canadian Art Museums Directors' Organization. If it meets with the pleasure of the committee, I would suggest that Mr. Carter start by presenting the brief of the Canadian Art Museums Directors' Organization.

The Chairman: That is fine. Yes, Mr. Carter.

Mr. David G. Carter, President, Canadian Art Museums Directors' Organization; Director, Montreal Museum of Fine Arts: Thank you, honourable senators. I hope that we may be able to offer you something of a change of pace. I did note in the comments of Mr. Peachey that we had an ally at least in certain sectors which I had not considered.

Since you do not have a resumé of the Canadian Art Museums Directors' Organization brief, I shall take the liberty of reading it to you. I should like to preface the brief itself by commenting on what the Canadian Art Museums Directors' Organization is. It consists of the directors of approximately 20 of the leading Canadian art museums across the country from St. John's to Greater Victoria. The submission to this organization depends upon basically three tenets: the professional standing of the staff itself; the professional level of the performance of the museum; and a minimum budget of $50,000.

If I may now begin with the brief itself, I have found a quotation that a colleague made in comment to the United States counterpart of this body which I think summarizes the basic philosophy behind our brief.

> The public good is served if cultural materials privately assembled are given to places of public use, and it is the business of law to encourage such gifts within legitimate limitations. A law that will prevent such gifts, and encourage the dispersal of collections by public sale instead of their gift to institutions where they will be available to all comers, is contrary to the public interest...

I took this statement from the testimony of Herman W. Liebert, Librarian of the Beinecke Rare Book Library at Yale University, offered before the United States Senate Committee in October 1969 to proposals in S. 2683.

Our special concerns relate to artists, collectors and public institutions. The art museums of the country hope their initial request to the Minister of Finance for equal treatment for all art museums qualifying

under Section 62(1)(e) of the Income Tax Act will receive further study.

I should like to make an aside here and indicate that we had submitted more than a year ago, prior to our present brief, a brief to the Minister of Finance, but none of the observations or recommendations we made in that brief were taken under advisement in the White Paper.

The Chairman: Are those recommendations that you submitted to the Minister of Finance incorporated in this brief?

Mr. Carter: They are incorporated in this brief, yes. I can submit for this committee a publication in article form which appeared actually in the November 1969 issue of *Canadian Antiques Collector* magazine.

The Chairman: All right.

Mr. Carter: We of the Canadian Art Museums Directors' Organization fear that the nature and value of the art museum and art gallery to our society may not be appreciated by the Government before it is too late. Our comments are, therefore, concerned with the policy of the White Paper in so far as it is urgent to our growth and survival.

Much of the health of all museums rests and will continue to rest on donations of property, securities, cash, art, antiques and objects of virtu. Section 2.19 of the White Paper states that it is proposed to continue existing deductions and arrangements for charitable donations, but it should be noted that the total received by all museums is slightly less than 1 per cent of the philanthropic dollar.

The present law in respect to all forms of donation imposes a ten-to-one handicap on those who would donate to privately or municipally incorporated institutions serving the public interest such as The Vancouver Art Gallery or The Montreal Museum of Fine Arts as opposed to those who would donate to federal or provincial institutions. We therefore ask the removal of the present limitation of 10 per cent on gifts to private and municipal institutions so as to allow the same 100 per cent deductibility for gifts as is given to federal and provincial institutions. Three city galleries now raising funds for building would be immeasurably helped by such a change—The Willistead Art Gallery of Windsor, Art Gallery of Hamilton and Winnipeg Art Gallery; and I might add that the Art Gallery of Greater Victoria is raising money to complete a new wing so that that would make a fourth institution currently requiring bricks and mortar funds. An increasing number of museums rely in part or in whole upon donations from individuals and corporations for their annual operations.

If we may turn to the subject of collectors and their vital relationship to museums and galleries, we would like to counter the impression that has been given that the sole concern for collecting art stems from a desire to make money. As museum men we have always found our greatest support from collectors, both individual and corporate, and should the income tax law be now amended as suggested herein it could result in an augmentation of our artistic patrimony in the public domain. If the present arrangements continue in effect we can only expect that the growth of the collections of Canadian institutions will fall increasingly behind those of foreign cities.

In this matter of the comparative quality of world's museums, our competition gives no quarter, and liberal conditions related to gifts to art museums and galleries were, for instance, embodied in the recent reform of the income tax law in the United States.

The Chairman: By the way, do you have a copy of that?

Mr. Carter: I have not received a copy, but I have an extract published by the Association of American Museums.

The Chairman: Could you send that to us?

Mr. Carter: I could provide that. The net result, if the White Paper is carried out, will be institutions incapable of offering their public the resources which they might justly expect.

In the context of this competition and its goals we should like to propose an incentive to giving which could be combined with the proposed capital gains tax. It is suggested that donations be allowed at cost price or fair market value whichever is greater at the time of gift. At the same time a donor should not be deemed to have obtained a capital gain on gifts of property, securities and tangible personal property appropriate to the exempt function of the donee. For example, gifts of art would be restricted to the type of institution that would use the gift in its work. This would provide an incentive which would create options favourable to the retention and educational application of our patrimony.

To paraphrase a colleague, "the ability of our art museums, art galleries and libraries,

to continue increasing their resources for the use of all students and scholars and for the education and enjoyment of the public is far too important to be endangered by a few persons who abuse the role of donor". You heard Mr. Peachey on that a few moments ago.

We should like to affirm that museum staffs, dealers and artists would be both willing and able to support a valuation procedure where connected with donations which could at the least serve as a check to instances of suspected abuse or as confirmation to the propriety of a legitimate claim.

The Chairman: What are you aiming at there? You speak about people who abuse the role of donor. Do you mean by that that they present a picture to the museum at a certain price?

Mr. Carter: They might present a picture to the museum at a figure which could possibly be considered an inflated price on the current market, and where such a mechanical appreciation is put forward, wherever the Government had any desire to confirm whether this was legitimate or whether it was inflated, a joint committee composed from the sectors of artistic life mentioned here could undertake this job. There is, I believe, a very sound precedent for this already in the United States between the Association of Art Museum Directors, of which I am also a member, and the Art and Antique Dealers Association of America which have performed this kind of service for the Internal Revenue Service of that country.

The Chairman: The point that bothers me is the use of the word "donor". My concept of a donor is somebody who gives something free or at a deflated price. But how do you apply that term in this situation or this is an indiscriminate use of the word "donor"?

Mr. Carter: I do not really see that it is contrary to current usage. If an item is currently worth a certain value, the individual may be properly considered to be donating that kind of value.

The Chairman: But I was assuming that he was donating it at a price, and that that is where the abuse was. But you mean that he is inflating the price and charging that off against his income. Is that it? You are not in fact paying for it.

Mr. Carter: We are not paying for it.

The Chairman: All right.

Mr. Carter: In the United States there have been combinations of donation and sale from, say, dealers who have contributed.

The Chairman: It is clarified in my mind now. But in this context, when you first spoke to us, I could not understand how a donor could be somebody who was presenting a picture to you and then asking you to pay for it.

Senator Molson: Mr. Chairman, this suggestion does not take care of the situation of an individual who acquires, perhaps through good luck, more than good management, art works of a very considerable value at a very low price and then two years later donates them at their proper value and practically clears his income tax for a long time to come. This has happened.

The Chairman: My mind is clear on it now.

Mr. Carter: That usually is based on knowledge on the part of the individual who is doing it. It takes an individual with knowledge to recognize that possibility, and I must say it does not happen very often.

The Chairman: You have made a suggestion here about a method of dealing with it so that a proper code of behaviour applies.

Mr. Gonthier: If I might add a word here to give a little background to that. The Montreal Museum, prior to the White Paper, had submitted a brief to the Minister of Finance, and in that brief we supported a recommendation made by the Canada Council concerning the problem of gifts in kind, in other words, gifts of works of art, and expressed the view that there was some doubt in the present administration of the law, if not in the law itself, as to whether gifts of works of art could be deducted as such. We received a reply from Mr. Benson who suggested that we should address that part of our communication to the Department of National Revenue. We did so and we received a reply from Mr. Sheppard of that Department, indicating that the Department would recognize in proper cases gifts of works of art as being deductible.

Senator Phillips (Rigaud): Deductible from income in the year of the gift?

Mr. Gonthier: Yes. I have a copy of that letter here if it is of interest to the committee. Nevertheless, there may be an improvement in the administration of the law through a suggestion such as has just been put forward by Mr. Carter as to how to establish what is a fair value.

The Chairman: You mean by having, as is mentioned here, a proper code of conduct. That would involve, I suppose, the setting up a review board or some kind of valuation procedures?

Mr. Carter: I might add parenthetically that the National Gallery of Canada has had a valuation committee for this purpose which has been in the past composed of the sort of mixture which has been suggested here.

Senator Phillips (Rigaud): Are we down to the point then that there seems to be no rationale for allowing complete deduction for gifts to the national art galleries federally and the provincial art galleries, and penalizing municipalities and museums supported by private individuals?

Mr. Carter: This is very much the present situation. We are trying to compete on a bicycle as against a Rolls Royce when you compare the current situation of the Montreal Museum or, let us say, the Art Gallery of Greater Victoria with that of the National Gallery or the Musee du Quebec.

Senator Phillips (Rigaud): The ones that need it least are getting the greatest benefit.

Mr. Carter: In terms of diffusion of means, absolutely, but I would not wish to convey that I thought the amounts spent on behalf of the federal or provincial museums were in any sense too great. We are hanging on by our fingernails as institutions and as a profession.

Senator Phillips (Rigaud): You are not asking that the federal giving be reduced to 10 per cent or that the provincial be reduced to 10 per cent, but rather the reverse, that the private museums and the municipal museums be given 100 per cent.

Mr. Carter: That is right. And I feel that it is absolutely critical to our case if we are going to compete with American museums.

Senator Phillips (Rigaud): Have you any information with respect to privileges given in countries other than the United States?

Mr. Chairman, the reason I am putting these points, if I may, is that I will not be here at 2.15 p.m., because I will be having duties in the house in connection with legislation, and I am anxious to get my observations across.

The Chairman: Yes.

Mr. Carter: I do not believe that dealing in terms of capital gains tax, or donations during one's lifetime, that the same advantages exist in any other country, except possibly Mexico where artists are allowed to give works of art as part payment of their income taxes.

In countries such as England the emphasis seems to be on the estate tax solution rather than on the current tax solution. I believe one of the clear reasons for the vitality and the growth of U.S. museums lies precisely in the fact that people will do far more if they can do it within their lifetime and if these is some clear-cut incentive to those individuals during their lifetime, and the results could presumably be enjoyed in terms of either a new gallery wing or a collection which may be seen by the general public honouring that particular donor.

Senator Phillips (Rigaud): And the odd editorial does not do any harm during the lifetime, which is perfectly legitimate, I suppose.

Mr. Carter: Yes.

We find the degree of bookkeeping proposed for collectors staggering, section 3.23. The idea of imposing a minimum valuation of $500 is fraught with administrative complications both for the individual and government, since the one category of art within this ceiling is the domain of graphics—that is to say, prints and drawings. Almost anything else, if I may embroider just for a moment, in the way of painting would go above that figure. Even with student work today, a student feels entitled to charge in excess of that simply in terms of reflecting a minimum wage for what he has put into his canvas.

Similar problems would be presented for those interests encompassing material of historical interest, such as maps, books, coins and stamps, which might be directed towards the National Archives or libraries of various kinds.

We would also point out that substantial prejudice would be caused to the collector when the value of his objects d'art has diminished substantially from their cost at valuation day. Conversely, the collector might well be paying a substantial capital gain on an increased value after valuation day which, in fact, is only a realization of a part of his initial cost. The premise that art incurs the same kind of capital increase as a security or as a savings account with compounded interest, does not take into consideration changes

of taste, re-evaluation of artistic quality—I would say there, by art historians and critics—and determination of condition—that is to say, something which you thought was in a perfect state and laboratory techniques today show you it is really a wreck—which may affect the market value of objects d'art upwards and downwards.

The Chairman: This is exactly in line with the representations we had from Mr. Ben Ward-Price of Toronto, where he was consulted by the Department of Finance, and I read it into the record the other day, but it is a pretty effective statement from a man who knows.

Mr. Carter: I am glad to hear it from that quarter.

With respect to objects d'art, we would suggest an election so be granted to the taxpayer that he should have the right to elect to be taxed on that portion of the capital gain that the length of time the taxpayer owns the objet d'art after valuation day bears to his entire period of ownership.

The Chairman: If the potential donor has a painting and it is valued on valuation date, and at a later period he donates it to a museum, let us call it the 10-per-center, how is he affected? Of course, the 10 per cent is either up or down, depending on the value at the time of the donation.

Mr. Carter: I touch on this in my next paragraph. In other words, I think it quite possible to donate and take a capital loss, as well as to take a capital gain.

The Chairman: That is right.

Mr. Carter: I see no reason why this is not as legitimate in the domain of art as it is in any other business sector.

If I may comment on it then, we find the restrictions of tax-deductibility of possible losses in the sale of objects d'art could cause substantial prejudice. Section 3.26 introduces the principle of treating capital losses in relation to tangible property which permits losses to be computed only against realized gains in the same category.

The Chairman: I am afraid you may have to do a little convincing of us on this point because of the larger question involved in relation to the whole system of capital gains. We have had evidence adduced here and there have been opinions expressed that if, for instance, in the last year the White Paper had been in force with capital gains, where you pay tax on capital gains and you write off capital losses, the revenues of Canada, by reason of the large losses in the market, would have shrunk by some billions of dollars by the capital losses which could be set off against earned income. In the United States they do not set if off.

Mr. Carter: This applies to gross income if you were to sell, let us say, a particular share of stock and experience a capital loss.

I would like to come back to this problem of valuation of art on another point, and that is I do not conceive it as imaginable that on valuation day there would be adequate expertise to go throughout the country and determine what the value of works of art in private possession actually come to. This kind of valuation clearly will have to be determined retroactively, based, I would suggest, at the time of donation or at the time of sale, if it is a sale in the public market.

The Chairman: This is what Mr. Ward-Price told the Finance Department, that there were not sufficient qualified valuators in Canada to undertake this work and do it to a deadline.

Mr. Carter: He is absolutely correct.

The Chairman: That is why he said the basis should be $5,000 instead of $500.

Mr. Carter: I have suggested a slightly lower minimum, but I would tend to agree that if inflation continues I would certainly favour the $5,000 mark.

It would oblige the collector to sell items of appreciated value within a very short period to offset capital losses incurred by sales of art, antiques and objects of virtue wherein the cost price was not reached. We would therefore suggest that the private collector should be treated in this type of asset in the same fashion as a dealer, section 3.27, which would avoid the spectacle of the collector trying to justify the fact that he was a dealer, a question of determination by degrees. This question of degree has occasioned substantial difference of opinion and apparently contradictory judicial decisions on the question of capital gains on real estate transactions in recent years where the Department of Revenue attempts to characterize the investor as a trader and the trader attempts to characterize himself as an investor.

The Chairman: Shall we read through the rest of this brief?

Mr. Carter: There is just one more page.

The Chairman: Very well.

Mr. Carter: We do not concur in the notion expressed in section 3.26 of no decrease in value through use of painting, sulptures, jewellery and coin and stamp collections.

That is to say that the assumption has been made in the White Paper that paintings are acquired only for profit. I could point out historically and from my museum experienre pictures that have been acquired by experts, in one instance for $70,000 which was spent in 1907. Approximately 50 years later that same picture was valued by the same institution at $5,000.

The differences of taste which were incurred may be illustrated historically by the fact that while Chicago private collectors collected post-impressionists when they were cheap and their value has gone up enormously, the Hague School of Painting was collected by Montreal collectors. Its value has gone down substantially from approximately the same moment.

The accounting of this has to be on the basis which I have suggested previously. However, I think it is clear that it is a two-way street.

It seems unfair to expect a collector upon emigrating or re-emigrating to another country to meet an economic iron curtain which would impose a capital gains tax both upon his intangible and his tangible property (paragraph 3.40); it would indeed have unfortunate effects—I might say the effects would be unfortunate without the United States—if the United States also were to accept this point on a reciprocal basis as a part of the tax convention between the two countries. Its immediate effect would be to inhibit the collection of art, antiques and objects of virtue, and further limit patronage to artists.

In connection with special rules, paragraph, 3.41, applying to gifts, in the spirit of the exemption recently enacted by the federal Government with regard to bequests to the spouse of the deceased, we would suggest that where the donor makes bequests of art to institutions with the children of the donor having the right to retain their use during their lifetime, this practice be allowed without being made subject to estate taxes.

I think in the submission prior to our own we heard some of the consequences of the crunch between the estate taxes and the proposed White Paper innovations that would occur with individuals and privately-held companies.

We ask whether conditions should not be included to exempt family heirlooms and family portraits from estate taxes, and to retain the capital gains tax should they be subject to sale at amounts in excess of $1,000. I would be prepared to upgrade that figure, of course.

The Canadian Art Museum Directors' Organization thanks you for listening to gheir brief. I would be happy to add comments to this.

I would like to indicate what has happened historically in this country in terms of the flow of art. I do not think that those who are not living with it day by day have a real awareness of the kind of slow and sometimes rather rapid bleeding which has occurred.

In that sense I have found myself looking at publications showing the twelfth century miniature in the Cleveland Museum of Art, formerly from a Canadian collection. I am speaking now of recent history. I know of a very famous Aelbert Cuyp landscape, formerly from an Ontario collection in an institution in St. Louis. There is a famous Rembrandt presently in the Fuller Foundation in Boston. This formerly belonged to James Ross, who was one of the early pillars of strength of the Montreal Museum of Fine Arts. There is a Corot, again from a Montreal private collection, which now belongs to a trustee of the Philadelphia Museum of Art. Another painting from the Ross collection is the Rubens today owned by the Ringling Museum in Sarasota. A Bronzino portrait which is from the Robert W. Reford collection went first on consignment to London on the settlement of the estate and was then acquired by the National Trust of Great Britain for Petworth. Last is a group of quite important vessels of early Canadian silver, which appeared in the last *Detroit Institute of Arts Bulletin.* I show you simply two. All these silversmiths are well known, from Robert Cruickshank to St. Laurent Amiot and François Ranvoyzé. This again has been the result of this lack of incentive—this very much needed encouragement which Canadian museums desire and which we feel is essential to doing our job.

We would favour in this sense not any form of restriction, but rather a climate of free trade, where incentives are directed to the benefit of the accrual in the public domain of institutions in this country.

I do not think that one can complain if institutions outside Canada have taken an interest in Canadian art per se. We have seen that in the Bushnell Collection in the Peabody Museum.

We have seen the reverse happen in the Glenbow Foundation, in which we see a Canadian museum also collecting not only Canadiana but Americana.

I would be glad to elaborate further on this point, but I believe you should have this glimpse of what we see in a way that has frequently been the cause of severe depression among Canadian museums and collectors of fine art.

Senator Phillips (Rigaud): I do not see a set of specified recommendations in your brief. The criticism, analysis and your summary thereof are obvious.

It would be very helpful to the committee if we were to receive as part of the record a suggested set of recommendations.

You refer, for instance, to the 100 per cent rule, federally and provincially, but you do not say in so many words what your recommendation or request is.

The Chairman: That request, of course, relates to the general law. The 10 per cent and 100 per cent are not special features of the White Paper.

Mr. Carter: No, this was actually neglected by those who prepared the White Paper. It was an inequity not observed.

The Chairman: The remaining statements in your brief deal with the treatment that is proposed in the case of losses.

Senator Molson: Estate duties.

The Chairman: Those are in the White Paper and you have made your submission on that point.

There were several other aspects that you dealt with in relation to dealers. What is your concern there?

Mr. Carter: Our concern there is to have collectors who, whether they sell or donate their collections, have assets in terms of art treated in the same fashion as dealers. Dealers, in other words, are permitted to treat art as a commodity which suffers profit and loss.

The Chairman: That is right.

Mr. Carter: I see no reason why that should not apply to private collectors as well.

Senator Everett: What is the advantage of that to the private collector?

Mr. Carter: The suggestion is made in the White Paper that the private collector could only deduct losses against gains made from his own collection. It does not take into account the idea that capital loss could be incurred as a result of what he was doing. It might be conceivable that everything he collected would be in the area of capital loss.

Senator Everett: You are seeking a general deductibility of art losses?

The Chairman: Or to phrase it another way, whether it is a collector or a dealer, what they are doing be classified as a business.

Senator Everett: I am frankly a little hesitant to classify a collector as a business man. If the objective is purely and simply to obtain the general deductibility of his art collection losses, I think you should say just that. Indeed, I think in one of the briefs you do.

Mr. Carter: This would not happen until he actually reached the point of liquidating something.

Senator Everett: That is correct.

The Chairman: If he makes it a business, how does that improve his situation? He can deduct his losses from his gains, but that is what the White Paper proposes anyway.

Senator Everett: The White Paper, as these gentlemen explain, combines the deductions from profits on art. What they wish is general deductibility.

Mr. Gonthier: Furthermore, it limits the deduction to one year carry back and one year carry forward on art, which is peculiar.

The Chairman: You have not said anything about that. You have not made any submission on that.

Mr. Gonthier: The submission is, I believe, that there should be no special or peculiar treatment of losses on art, that it should be treated in the same way as other losses. I think this must be put back in perspective. This is an alternative; this is a second string to our bow, if capital gains or deemed realization on works of art are retained—because we make the first recommendation that there should be no deemed realization of capital gains, or no capital gains on art given to

museums, which, as you may know, is the situation in the United States...

Senator Everett: I just want to follow that up very briefly. Your suggestion is that there be no capital gain on art given to a recognized museum, and full deductibility at market value from other income?

Mr. Carter: Right.

Senator Everett: Is that the situation that obtains in the United States?

The Chairman: Yes.

Mr. Gonthier: The situation in the United States, as I understand it now, under the 1969 tax reform, as regards works of art given by a donor who is not the artist himself who has created the work, is that there is no capital gain, there is no appreciation on the one hand, and on the other hand there is a deduction, a donation, at full market value.

Senator Molson: From general income.

Mr. Gonthier: From the adjusted gross income, as they call it.

Senator Everett: So, in effect, what you are suggesting is that the Canadian law be the same as the American law in this regard?

Mr. Gonthier: Yes. In the United States the deductibility for works of art is not 100 per cent; there is a maximum of 30 per cent of adjusted gross income, but that can be carried forward for five years.

Senator Phillips (Rigaud): I think it very important, Mr Chairman, that we obtain as part of our record a summary of the present American legislation, accompanied by a more formal request that this committee consider the introduction into the Canadian tax system of the American set-up. It is true that the Chairman indicates intentionally that our jurisdiction may not go beyond the consideration of those phases that relate themselves to the White Paper, but I think the Chairman will agree that at least in submitting the material I do not think we need limit ourselves specifically to that.

The Chairman: No, but I do think that we need a request.

Mr. Gonthier: The White Paper does deal with this subject in one section, where it states in effect that it is felt there is no need to make any changes to the present law governing the deductions, except I think as regards sports associations.

The Chairman: Well, I suppose sport is a form of art.

Mr. Carter: There is one minor detail in this valuation procedure, which I am not sure has not been overlooked. The option would be offered to either donate at cost price to the individual or at the present fair market value, which in the case of something acquired in 1907 would not then become a financial disaster.

Senator Phillips (Rigaud): Mr. Chairman, I am pressing the pointl Is it agreed, through you, that the committee is asking that we do get a summary of what the American law is on the subject under the new law, and what the request is from this group?

The Chairman: Yes. I specifically underlined that we require a request, and the sooner we get that in the sooner will we get it into our material.

Mr. Gonthier: Certainly, we will be pleased to do that.

The Chairman: The proposal is that we resume at 2.15, and meet in our regular room downstairs, when we will hear the brief from the Montreal Museum of Fine Arts.

The committee adjourned.

Upon resuming at 2.15 p.m.

The Chairman: Honourable Senators, it is exactly 2.15 p.m. and I will call the meeting to order. This afternoon we have another brief from the Montreal Museum of Fine Arts. You already met these gentlemen this morning but we have a few senators who were not here. For your information, this is Mr. Gonthier, Dr. Murphy, and Mr. Carter.

Mr. Gonthier: Mr. Chairman, if I may, Mr. Carter would just like to say one word arising out of certain questions that were put at the very end of the hearing this morning so that the record will be clear as to the stand that the Canadian Art Museum directors Association is taking with respect to the treatment given in the United States regarding gifts from museums.

Mr. Carter: I believe the impression may have been left that we were interested in copying the United States. This is far from the case, because we are interested in using the capital gains tax as an appropriate vehicle for our purposes. If we are going to obtain the sort of position our institutions should have in this world, we must have the best incentives that can be conceived.

One other instance occurred to me and that is the kind of bleeding we have experienced and which began in northern Ontario. The United States has reached the stage where it seems to have accepted Joseph Hirschorn's collection lock, stock and barrel and it is about to build a museum on the Mall in Washington. I feel in my own heart that this might have happened here had there been incentives of an adequate nature to encourage the collection to remain in Canada. This is the Joseph Hirschorn's collection which is the greatest collection of contemporary art.

The Chairman: Senator Aird and myself are very close to it. I suppose it goes back for me to 1934, and for you, Senator Aird, shortly after that.

Senator Aird: I think it was 1945. I am sorry, but I did not get the purport of the remarks.

The Chairman: Dr. Carter was referring to the fact that if we had had the proper incentives here in Canada we might have been able to retain this man who had contributed greatly to the development of the north country. I do not think they should be bleeding, because you and I could both tell them that it would not have come here in any event.

Senator Aird: I must say that the Toronto art gallery made very strong efforts to interest Mr. Hirschorn in its facilities. I think his decision, as the Chairman stated, was made quite independently.

The Chairman: No matter what the circumstances and attractions were I think it would have been established where it is, and I know what I am talking about.

Mr. Carter: I cannot contest that specific case, but I certainly believe that incentive is going to assist donation.

The Chairman: Was there something more that you wanted to add.

Mr. Carter: I believe the other thing which I could add would be comments on Dr. Murphy's presentation.

The Chairman: We will go on to the brief of the Montreal Museum of Fine Arts.

Dr. Sean Murphy, president, Montreal Museum of Fine Arts: Thank you, Mr. Chairman.

The Chairman: I think the senators all know what the point is in this discussion. It is regarding certain donations to a certain class of museums which will carry 100 per cent exemption and others only ten per cent so far as the donor is concerned. That is one of the provisions and there are several others referred to in the brief as to the treatment in the White Paper of write-offs.

Dr. Murphy: Mr. Chairman, honourable senators we appreciate the opportunity of appearing before you. This brief is short and it concentrates on items which we feel are crucial, therefore, what I am going to mention here is crucial to the Montreal Museum of Fine Arts. I feel this is also applicable to other private museums in Canada.

The concern of the Montreal Museum of Fine Arts is the failure of the White Paper proposals for tax reform to correct certain inequities in the treatment of museums under existing legislation. We also wish to draw the committee's attention to certain proposals relating to capital gains which discriminates against the collection of works of art. In this connection the Canada Council has found that one of their greatest problems is taxation which in their view does not recognize the special conditions under which the arts operate nor their status in the community. We feel that the White Paper policy has been conceived entirely in the light of economic criteria, and this is particularly evidenced by section 1.10 of the White Paper. We do not wish to diminish the importance of these criteria, but we think, though all must agree, that the artistic life of the community cannot be governed solely by economic factors. It is not our purpose to deal in any way with the general policy expressed in the White Paper. We do not consider this to be our special field.

The Montreal Museum of Fine Arts is the oldest institution in its field in Canada, having been created by special statute of Parliament of the province of Canada in 1860 on private initiative so that Montreal might have an art museum open to the public. Its collection is the most important one in the province of Quebec and ranks with the two other most important art collections in this country. Hence, I feel we are dealing with a national treasure of the first magnitude. I do not think this can be stated strongly enough. This institution fulfils an important cultural and educational function, yet it is unable for financial reasons to meet the public demand. Therefore

its services are rapidly increasing in terms of people being better educated and having more leisure time to go to museums.

The support this institution receives from three levels of government accounts for approximately one third of our total moneys. The remaining two thirds come from the private sector. It is this two thirds we are concerned with because we do not see any incentive for donors to contribute significant amounts of money for the continuation of this institution. The one third from the government is clearly inadequate to operate the institution.

The museum can only hope to raise the funds it requires if government encourages private generosity by granting a more favourable treatment of gifts to museums than at present exists. 85 per cent of the objects—that is, the paintings and the sculptures—in the Montreal museum, have been given by private donations, over the years and those items which have been acquired or bought have been acquired with funds which have been given privately.

Such a policy would produce great benefits in terms of funds for the museum, but this naturally carries over to the community for the value of the community and the individual citizen. In this way the preservation of works of art for Canada would be achieved at a nominal cost to the government.

Montreal has been one of the major centres for private art collections in north America. Some of these works have been given to our museum, others still remain in private hands, and many others have been lost to the country, and we heard about these in the brief this morning from the Canadian Museum Directors' Organization, which brief we of the Montreal Museum endorse. Now these works have been lost, many of them irretrievably, because their market value today renders their repurchase prohibitive. Soon such collections will be a thing of the past. Now the problem here is that Canada is indirect competition with the United States and unless there be some incentive to give them to museums in this country, rather than to sell them, we are convinced that many of these works of great masters will be lost to future generations of Canadians. So we submit that the museum art collections are worthy of being encouraged, and that this interpretation can fall under section 1.11 of the White Paper.

Now, the reforms that we feel are required are as follows; (A) The Government has recently recognized the problem to some extent under present legislation by allowing 100 per cent deductibility for gifts to Her Majesty in Right of Canada or in Right of a province (Sec. 27(1)(b)). These gifts are not subject to a ceiling of 10 per cent of net income. This provision is applicable to the National Gallery and provincial museums but does not extend to major institutions such as our museum which answer a similar public need in a centre of great population. This legislation places the latter in an inferior position. It is discriminatory and damaging to the retention in Canada of our national treasures. It is urgent that the situation be corrected and we believe that this could appropriately be achieved by making gifts to museums which qualify as charitable organizations fully deductible from net income.

(B) The White Paper provides in section 3.41 that, where property is given, the donor is deemed to have sold the asset at its fair market value and to have a gift of the proceeds of the sale. This proposed rule provides no incentive to encourage the gift of works of art to Canadian museums and puts Canadian museums at a very serious disadvantage as compared to their counterparts in the United States. We suggest with reference to gifts of works of art to recognized museums that the difference between the value of the work of art on the date of gift and its cost not be taxable.

(C) With respect to losses incurred on works of art, section 3.26 allows them to be deducted only from gains obtained on the same type of property in the current year, the year preceding or the year following. Since gains realized on works of art are taxable in the same manner as gains on other property, works of art should be treated in the same manner as other property with respect to losses, and a loss incurred upon disposal of a work of art should be deductible from capital gains on any property and should be carried back and carried forward the same as any other losses. Any other approach discriminates against works of art which, unlike most property, constitute an asset of permanent value not only for their owner but for our country as a whole as part of the national heritage. We feel, in other words, that our institution and other institutions like ours are faced with a financial crisis for survival. We also feel that

if we are to grow, we must seek capital gifts, and unless a climate which encourages these capital gifts is provided, we fail to see how these institutions can be kept viable and strong and meaningful for the people of Canada. Thank you.

The Chairman: Are there any questions?

Senator Laird: Just for the record, Mr. Chairman, since it was mentioned this morning in connection with the previous brief, I would like to point out now in connection with this brief that the Willistead Art Gallery in Windsor is in the same situation as you are in, and being from Windsor, I have a special interest in it. I trust the committee will support the point you have presented this morning and again this afternoon. That is purely for the record, Mr. Chairman.

Mr. Gonthier: In this connection, may I interject to state that I understand the Willstead Gallery is planning some further expansion and I wonder if Dr. Murphy might say a word regarding the needs of the Montreal Museum and its present position in relation to space.

Dr. Murphy: Our position, senator, is such that roughly 80 per cent of our collections has to be kept down in the basement at any one time due to the tremendous shortage of space. Now for some time we have attempted to expand, but we feel that with the 10 per cent limitation on gifts, it has been almost impossible to solicit enough funds to enlarge by either a new wing or a new building altogether. Therefore our growth at the moment is absolutely stunted and the community is not enjoying the full benefit or the full value either from the pleasure point of view or the educational point of view, of what the museum does. In addition, the conservation of priceless early Canadian paintings is in danger because along with the lack of money to expand, there is a lack of money to attract adequate expert personnel. These things have a habit of joining themselves one to the other.

Senator Laird: I suppose that you are aware that we are in the same boat in Windsor with regard to the Willistead Gallery.

Dr. Murphy: I think this was mentioned this morning.

Senator Macnaughton: On the same line of questioning, Mr. Chairman, I don't know if any figure has been given as to the tremendous increase in attendance at the Montreal Museum of Fine Art. A few years ago it was a privately owned museum and only a few people went.

Dr. Murphy: Yes. This institution has become transformed in about the last ten or fifteen years—the last ten years essentially. And it now caters to a very wide public. The attendance figures range from roughly 200,000 to 350,000 a year depending largely on the type of exhibition we succeed in putting together. If we can find enough money to bring in, say, a Rembrandt exhibition, the attendance goes away up, but it is in this range, 200,000 to 350,000 a year and therefore serves a wide sector of the public.

Senator Macnaughton: Would it be correct to say that about 70 per cent of your attendance would be French-speaking Canadians?

Dr. Murphy: We ran a survey of this about a year ago, and at that time we discovered that our attendance was about 50-50 English-speaking and French-speaking. This was a small sampling during one specific exhibition. We think that to answer your question fully we would need a bigger sampling over a longer period of time. But the French attendance has been rising dramatically.

Senator Macnaughton: Could you say something about—I do not like to use the word "class" of people, but let us say the age of people who are attending. I understand it is becoming younger and younger.

Dr. Murphy: This is very obvious. Any week-end or Sunday that one goes in now, you will notice many, many young people there.

Senator Macnaughton: Schools and constitutions?

Dr. Murphy: There are tours for school children, and any afternoon that one goes, one will see the museum crowded with children. The attendance of these school children's tours runs somewhere around 20,000 to 25,000 a year.

Senator Macnaughton: It may have been correct to have called it a private institution originally, but certainly now it is a public institution.

Dr. Murphy: That is right. It has grown up in such a way that now it is really a public museum.

Senator Everett: In light of the fact that the same witnesses are here, I should like to ask a

question on this morning's brief, if I may. On page 6 you state:

> With respect to objets d'art, we would suggest an election so be granted to the taxpayer that he should have the right to elect to be taxed on that portion of the capital gain that the length of time the taxpayer owns the objet d'art after valuation day bears to his entire period of ownership.

Could you explain that paragraph to me, and explain its effect?

Mr. Carter: I think its effect would be, in a practical illustration, something that was acquired by inheritance, perhaps purchased at a very low price, which perhaps had even been owned or bought by an individual who had held the object for, say, the greater part of his life. The election here would probably affect older collectors rather than younger ones. I would assume that newer collectors would prefer the option of taking the capital gain on the basis of either the donation figure, which would be the current fair market price, or, as is suggested in the brief, at the purchase price if that were the more advantageous figure for him. In this case it is a sliding element in terms of time, and this may be a more difficult thing to augment in practice.

Senator Everett: Could you give me an example, using figures, of how it might work?

Mr. Carter: The election?

Senator Everett: The operation of the paragraph I have just read to you.

Mr. Carter: I would have to compute it.

Senator Everett: Perhaps, Mr. Chairman, since they are filing other information, the witnesses could be asked if they could file an example of the operation of this paragraph.

The Chairman: It seems to me that the key is in the language of paragraph 3.41 of the White Paper. That is where, if the donor is going to make a gift of, say, a painting to a museum, the White Paper says that the first step is to presume that he has sold it at the fair market value, and then he makes a gift of the proceeds to the museum. The effect of this, of course, I would think, is two-fold. If he is a 10 per center he can only write off 10 per cent of the gift, and if the presumed sale produces a gain he is subject to capital gains tax on it. This is a pretty big hurdle for any donor who is contemplating making a gift of paintings, for instance, or any other article to a museum. It seems to me right in that paragraph. If they remove the presumption of a sale and just accept it as a gift, as long as the value is not in excess of a certain amount—and possibly we should think in terms of $5,000...

Senator Everett: I wonder if you and I are on the same paragraph.

The Chairman: I am looking at paragraph 3.41.

Senator Everett: I am referring to the second paragraph on page 6 of the brief of the Canadian Art Museums Directors' Organization.

The Chairman: I am referring to the White Paper. I thought the key to our problem may be in that paragraph in the White Paper.

Senator Everett: I think it is, but they have suggested a right to elect to be taxed on that portion of the capital gain that the length of time the taxpaper owns the object d'art after valuation day bears to his entire period of ownership. What I was requesting was an example, using figures, of how this would work.

The Chairman: I think that would be interesting, but it sounds as though it may present administrative problems in the proper administration of such a basis. Valuation day may establish a value higher or lower than cost. If it established a value lower than the original cost, at a later date when the gift is made, and maybe the painter has come into favour and the value of his paintings has gone up, the donor will be hit with quite a wallop, enough to discourage him from making the gift. The only alternative I see to permitting a straight gift would be perhaps to contemplate a capital gains tax that would not be so onerous as to provent people from making gifts.

Senator Benidickson: What is the position if the gift of the object d'art is made by bequest? Would a charitable bequest be considered tax free? Would a gift at the time of death escape estate tax?

Mr. Gonthier: As such I believe it would, because it would be a gift to a charitable organization, but there may be incidence in relation to the taxation of the remainder of the estate nevertheless. You have probably heard about tax on tax, depending upon the manner in which the will may be drafted.

Senator Benidickson: I am thinking of escaping tax rather than the utilization during the lifetime of the 10 per cent provision, that the gift by bequest would escape estate duty. Would it bear a capital gains tax under the White Paper?

Mr. Gonthier: Well, yes, it would.

Senator Benidickson: Fair market value at the time of death?

Mr. Gonthier: Exactly.

Senator Benidickson: Notwithstanding that it would escape estate taxes, the estate would have to pay capital gains tax under the provisions of the White Paper.

The Chairman: It might, except—this is just speculation—there is a provision where you have a crunch as between the effect of the estate tax and the effect of the capital gains tax falling in at the moment of death. The White Paper does propose something to avoid the collision and impact of the two taxes, so that the gift would bear the cost of the donor of the gift, which I take it would mean the valuation at that time, but the payment of the tax, the capital gains tax, if there was a capital gains tax, would be deferred until some transfer had been made by the beneficiary of the gift. That may offer some little comfort, because if it applied in this case it would mean that the museum as the beneficiary of the gift might never dispose of it. It may be open to that interpretation under the White Paper. We would have to have a look at it. It is hard to accept that donations to the federal authority or to provincial authorities of pictures, paintings etc. are 100 per cent exempt.

Senator Benidickson: Even during the life time of the donor.

The Chairman: Yes, and yet the rest of these places which are equally worthy in the public eye and the contribution they make, form the ten per cent clause. The whole question is whether this is capable of abuse. Frankly I do not think so.

Senator Macnaughton: It is no abuse in the United States.

The Chairman: No. The answer against abuse is that it is permitted as far as federal and provincial institutions are concerned. It is a problem, and after all once in a while, at any rate, we have to look at the cultural side of things. It is nice to be educated as well as to have some scientific knowledge.

22007—4½

Mr. Carter: May I return to Senator Everett's point in regard to the paragraph on page 6. This really applies to private collectors who would finally be put in a position to sell their art so that the cushion of tax would be softened for them. If the work of art is donated to a museum the degree of incentives which museums are asking for is greater than that and does not imply any percentage of this kind as a cushion for private individuals. For example, if we have a painting which has been owned half the time by the collector before the evaluation date he would then be taxed for 50 per cent of that capital gain under this particular paragraph when he sold that work. If that individual plans to give that picture to a museum then he would receive the full 100 per cent deduction now permitted with no deemed capital gains. This is really designed only to permit private collectors to continue where they have elected another choice. It may be, for example, in defining a picture, to have one of better quality than to get rid of an inferior one. This kind of choice would suit both the private collector and the museum, because it permits a quality.

Senator Giguère: In the case of the painting being donated to a museum who would determine its value for tax purposes?

Mr. Carter: I have suggested in the brief this morning that this would be between the donor and the Receiver General. It should not be the museum itself which would have to arbitrate. Regarding problems which the Receiver General's office might wish to bring under further scrutiny I propose as a further instrument that there be established a committee composed of art museum men and dealers and collectors who could adjudicate any cases which were felt to be abuses, and determine whether they were legitimate or not.

Senator Giguère: Otherwise you could have terrific competition between museums.

Mr. Carter: This competition exists, but I believe if the responsibility lies directly between the collector and the Receiver General that this is the best way.

Senator Giguère: Thank you.

The Chairman: Are there any other questions.

Senator Desruisseaux: What percentage of paintings do you receive as gifts in relation to

the total number of paintings you have on hand?

Dr. Murphy: Around 85 per cent. The remaining 15 per cent was purchased with funds which had been donated by private individuals and companies.

Senator Desruisseaux: How many members have you got?

Dr. Murphy: Seven thousand.

Senator Desruisseaux: Is that the highest that you have?

Dr. Murphy: Yes, we built that up over the years. It compares very favourably with institutions of this size in other centres in North America.

Senator Desruisseaux: Do you have a board of governors or directors?

Dr. Murphy: We have a board of 30 councillors and trustees.

Senator Desruisseaux: How are these chosen, by the members.

Dr. Murphy: These are chosen by the members and any member may put up somebody for election to the board if he so wishes.

The Chairman: I assume there are membership fees.

Dr. Murphy: That is right. This, of course, contributes to the operation of the institution.

The Chairman: Are there any other questions?

Mr. Gonthier: In connection with your reference to section 3.41 of the White Paper we entirely agree that is the crux of the matter. We have prepared a very simple sheet here which shows the effect of the White Paper proposal as compared to our recommendation which is that there should be no capital gain on the one hand and on the other hand the fair market value of the gift should be deductible from income.

The Chairman: We will incorporate it in our proceedings today.

THE MONTREAL MUSEUM OF FINE ARTS

White Paper Proposal

—Capital gain taxed on deemed realization (via gift).

—Full fair market value deductible from income.

—Deduction for charitable gift limited to 10% of income.

Recommendation of The Montreal Museum of Fine Arts

—Capital gain not taxed on deemed realization (via gift).

—Fair market value deductible from income.

—Deduction for charitable gift not limited (i.e., 100% deductible).

Assumption

—Taxpayer with salary and other income of $50,000.

—Painting with a cost basis of $10,000 and a fair market value at time of gift of $30,000.

	White Paper Proposal	Museum Recommendation	Present	
			M.M.F.A.	Nat'l Gallery
Year 1	$	$	$	$
Salary and other income	50,000	50,000	50,000	50,000
Capital gain	20,000	—	—	
Income	70,000	50,000	50,000	50,000
Charitable donation	(7,000)	(30,000)	(5,000)	(30,000)
Taxable income (ignoring exemptions)	63,000*	20,000	45,000	20,000
Year 2				
Salary and other income	50,000	50,000	50,000	50,000
Charitable donation	(5,000)	—	(5,000)	—
	45,000**	50,000	45,000	50,000

NOTES

*Under the White Paper proposals, by donating a painting, the taxpayer pays tax on $63,000 rather than $50,000.

**If carryover for donations is not extended, taxpayer pays tax on $20,000 capital gain, and may deduct only $12,000 ($7,000+$5,000) as charitable donations.

Mr. Gonthier: I will be very happy to explain this to you. The White Paper proposal is, first of all, that capital gains be taxable on the deemed realization. Secondly, it proposes that the full fair market value be deductible from income, which is no change from the present legislation, but that this deduction be limited to ten per cent of the net income of the taxpayer. Our recommendations on the other hand are that there should be no capital gains tax on gifts to the museum and that the fair market value be deductible from income, and that there be no limitation on that deduction by the taxpayer. This, for example, assumes that the taxpayer has a salary and other income of $50,000. He owns a painting which he purchased at a price of $10,000, and which has a fair market value at the time of gift of $30,000.

Under the White Paper proposal his income in the year of the gift would be $50,000 plus a capital gain of $20,000, namely the difference between $30,000, being a fair market value and his cost of $10 thousand. He ahs a total income, therefore, of $70,000. He can deduct up to ten percent as a charitable donation. Therefore, in the first year he is entitled to a deduction of $7,000 and his taxable income, ignoring personal exemptions and such, would be $63,000. In the second year he could deduct another $5,000 assuming that his salary and other income is $50,000, ten per cent a gain.

Senator Benidickson: This is all assuming that he makes no other charitable donations.

Mr. Gonthier: Exactly.

Senator Everett: Is he able to go on deducting until he reaches the full value?

Mr. Gonthier: No, he cannot deduct after the second year, because it stops after the second year under the present legislation. I believe there is no change in that.

Under the museum recommendation his total income would be $50,000, and there would be no capital gain. He could then deduct the full amount of his gift of $30,000 in that year and he would be taxable on $20,000. In the second year he would have no further deduction, of course, having deducted the full amount in the first year.

Now one can compare this with the present-day situation. If you compare it to the present-day situation of the National Gallery or any provincial museum, you can see that there would be no change from the situation which exists today. Granted there would be some benefit indirectly because of course other income generally would include capital gains, and here none would be included. As regards the present situation of the Montreal Museum, well, you can see that today his taxable income would be in the first year $45,000 and in the second year it would again be $45,000. So that the White Paper proposals constitute a very serious deterioration to the position of the donor whether he be a donor to our museum or to the National Gallery, but it is even more acute as regards our museum.

The Chairman: I am wondering whether consideration has been given to this situation or if it has been tried; if a person or a donor wishing to donate a painting to your museum decided that he would donate this year one-fifth or one-tenth undivided interest in the picture, and it would be valued and in each year thereafter, he decided to donate another one-tenth or one-fifth interest—that would lighten the load.

Mr. Gonthier: That may help in some cases, but we have to remember that our very special concern at this time is to retain in Canada works of great masters. Now I do not think it is generally known, but as is mentioned in this paper, Montreal was one of the greatest centres of private collections in North America bar none either in this country or the United States. It was one of the largest centres and there are still some of those works around. Now in a few more years we expect that all those works will be in museums and will therefore be frozen. They will be there for ever. I mean once the Metropolitan in New York has a Rembrandt, it keeps it. So there is the matter of attracting large gifts from a limited number of persons, and if you have that situation, then you run into the 10 per cent ceiling very quickly, and you must keep in mind that these possible donors may have several of these works, so it is no help to spread one work over several years because then you will not get the other work. Further, it may create problems for estate tax or succession duties, because, as you know, gifts that are made within five years of death under the Quebec Succession Duties Act, and I think in Ontario it is the same, and within three years under the federal act are deemed to be part of the estate, and these donors are apt to be elderly people who only have a limited number of years to survive. So that they will be faced, if you spread the donation over several years, with finding themselves in the position of being caught for both capital gains and estate tax.

The Chairman: It looks like a problem.

Senator Macnaughton: The gift by the Cummings Foundation of Chicago of the Henry Moore on your front steps—they would get credit with the American authorities, and to you it was a straight gift.

Mr. Carter: If I may reply to that, this was made actually as an exchange for something previously donated, and the previous donation was made prior to June 30, 1963. Prior to that date, it was possible for United States citizens to donate to institutions outside the United States and receive credit. That is not now possible. It might be to our ultimate advantage to find some reciprocal channels.

Senator Desruisseaux: Does the same thing hold true if you put it in reverse?

Mr. Carter: To the extent, that a Canadian citizen has an American income, but I do not know that there is any possibility outside that, and I do not think the 10 per cent would apply.

The Chairman: This might be a good subject matter for the new tax treaty that Mr. Benson will have to negotiate with the United States, because a tax treaty can supersede the statutory tax laws of Canada, and that is what it says right in the bill confirming the tax treaty.

If there are no further questions, I want to thank you three gentlemen very much for being before us. We will now adjourn until tomorrow morning at 9 o'clock when we will have two briefs before us.

Whereupon the committee adjourned.

APPENDIX "A"

A BRIEF

CONCERNING

THE WHITE PAPER ON TAXATION

SUBMISSION TO THE

BANKING, TRADE AND COMMERCE COMMITTEE
SENATE OF CANADA

AND

COMMITTEE ON FINANCE, TRADE AND ECONOMIC AFFAIRS
HOUSE OF COMMONS, CANADA

PRESENTED
BY THE

CANADIAN RETAIL HARDWARE ASSOCIATION

MARCH 1970

CANADIAN RETAIL HARDWARE ASSOCIATION — ASSOCIATION CANADIENNE DES DÉTAILLANTS EN QUINCAILLERIE

290 MERTON STREET, TORONTO 295, ONTARIO, TELEPHONE 485-0793

March 13, 1970.

The Chairman and Members,
Banking, Trade and Commerce Committee,
Senate of Canada,
Parliament of Canada,
Ottawa, Canada.

Gentlemen,

The attached brief is respectfully submitted by the Canadian Retail Hardware Association on the topic of the White Paper entitled "Proposals for Tax Reform".

We earnestly commend the brief to your thoughtful attention and wish to express our pleasure in being afforded the opportunity to comment in this important area before the proposals are implemented in law.

Sincerely,

Thomas M. Ross, B.Sc.Phm.,M.B.A.,
Executive Director.

TMR/vl
Attach.

SUMMARY

S.1 This brief concerning the White Paper on Tax Reform is respectfully submitted by the Canadian Retail Hardware Association on behalf of its members. The Association is a voluntary trade organization having approximately 1,400 members from coast-to-coast in Canada, all of whom are independent retail hardware stores.

S.2 The Association finds in the White Paper bias against small businessmen, unintentional as it may be. We suggest that the document was prepared by people familiar with large-scale operations to meet criteria dictated by such firms. Our contention is that the small businessman was "fitted into" a structure which was quite oblivious to his special needs.

S.3 There are grave dangers in the White Paper proposals for the hardware retailer. The elimination of the two-tiered system of corporate tax will severely restrict the retailer's chief source of expansion capital - after-tax corporate profits. As well as restricting his means to expand, the incentive to expand through partial tax deferral under the present system will be removed. A considerable proportion of the incentive to enter the high-risk, long-hour retail trade is also removed. The consequences, we suggest, will lead to fewer and more static retail outlets.

S.4 Because the tax proposals have stronger effect on small retailers than large, delicate competitive balances will be upset with the result of increased concentration in retailing.

S.5 We fear the economic consequences of the corporate tax proposals not just on our members. They are bound to stimulate retail price increases as retailers strive to replace tax-confiscated profits through widening their margins. This alone could touch off an inflationary spiral of major proportion.

S.6 We sincerely question the application of the capital gains tax at full personal marginal tax rates since, to some extent at least, it is a tax on inflated values.

S.7 We foresee the end of family-owned hardware businesses at the end of the present generation as a consequence of both the White Paper proposals and the year-old estate and gift taxes. If the next generation can afford to take over their fathers' stores, the lack of incentive will deter them from doing so.

S.8 We are concerned also with the White Paper's attitude toward the expense of attendance at conventions and seminars. We wonder at the logic that leads the proposals to suggest taxation of investment income of non-profit organizations while exempting labour and religious organizations. Because our members compete with co-operatives, they cannot understand the stance of the White Paper in recognizing the special privileges of these organizations but removing only some of them.

S.9 The hardware retailer as a small businessman seems to feel the effects of most of the changes proposed in the White Paper. He is a member of the middle-income group so he will feel the weight of increased personal tax rates. He is a small businessman so he will suffer a considerable increase in corporation taxes. Often he owns the building in which his store is located so in this way, and others, he will face capital gains taxes. Since he is independent and depends on conventions and seminars to increase his expertise, he will be affected by this and other disallowed expenses.

S.10 As a businessman he has often entered into long-term commitments and is now unsure as to how he will be able to meet these obligations under a new set of rules. He finds his main source of capital may be severely compromised and he wonders who will want to buy his business with incentives missing when he is ready to retire. He is still trying in many cases to calculate how he can pass on the business to his son with the resent estate and gift tax increases.

S.11 He is confused and frightened. He would be mad, but he is too confused by the complexity and inter-relationship of the proposals in the White Paper to voice his anger.

S.12 Individual tax changes within the White Paper are dangerous enough to the retailer. The full weight of all the proposals taken together and added to increasing municipal and provincial taxation could well be fatal to his business.

S.13 More than anything else, we plead for reason and restraint. Although the present tax system has many faults, it has allowed notable progress in the development of one of the highest standards of living in the world today. We plead that it be revised in simple and gradual units of reform. The hardware retailer might not survive such a violent upheaval in the taxation system as that contained in the White Paper; we suggest that the Country might not either, and we ask whether our present tax structure is so bad that we must rush recklessly into such traumatic change.

S.14 It is impossible in a summary of this length to describe all of our thoughts. We respectfully refer Members of the Committee to the body of the brief and particularly draw your attention to our recommendations as set out in Section 9.

S.15 We deeply appreciate the opportunity of stating our views and we would assure the Committee of our sincerity.

F O R E W O R D

> "Its aim is to reduce all action, all thought, and all feeling to a common denominator. It forbids independence and kills inventiveness; condemns those who ignore it and banishes those who oppose it".

The above quotation is attributed to the Right Honourable Pierre E. Trudeau, Prime Minister of Canada, in the February 24, 1970 edition of Look magazine. If we are to believe the published account, the Prime Minister used these words to mirror his distrust of public opinion.

This document is a considered synthesis of an important sector of public opinion on the White Paper on Tax Reform. It speaks specifically for independent hardware retailers in Canada; but it speaks for them not as members of a specialized trade so much as it reflects their views as retailers, or even as small to-medium-sized businessmen.

The document is admittedly critical of basic proposals contained in the White Paper. The quotation that heads this foreword could easily be interpreted as the views of this brief toward the proposals and we apologize to the Prime Minister for re-directing his comment in this way to our own ends.

We believe the White Paper proposals to be dangerous to small business because they will lessen entrepreneurial initiative

and endanger the status of family businesses within one generation. We believe that they are dangerous to the overall economic well-being of Canada in the same area because we are proud enough to believe that small business is economically important as the customer of large businesses and as the fertile soil from which large businesses develop.

Because we stand firmly opposed to many of the proposals contained in the White Paper, it may be assumed that we oppose tax reform generally. This is not the case. No tax system is perfect and in Canada, as elsewhere, there is need for constant reform consistent with changes in the economy and social obligations of the day. Our economy is a delicate balance of many factors. In such an atmosphere taxation change should be implemented carefully and cautiously with the effects of each change thoughtfully sifted before moving to the next stage.

If the White Paper proposals had been set forth as an objective toward which the system would work in easy stages of implementation and subject to review at each stage, our objections would be somewhat tempered perhaps. In its present form the White Paper attempts to radically re-define Canadian taxation and social order in a single step. We believe this to be reckless in the extreme.

We take issue also with the apparent government view that present methods of taxation are bad. Certainly there are deficiencies in the system but this does not automatically condemn the basic concepts of the system. Canadians have managed to attain one of the highest standards of living in the world. Considerable social reform has taken place. We do not believe that a bad tax system would have supported these results. We do not believe that the evidence suggests the need for radical reform of a system within which so much has been accomplished.

Defenders of the White Paper have put forward convincing argument for the implementation of its proposals. Detractors have also been vocal concerning the probability or possibility of adverse and damaging effects. We suggest there is a strong possibility that the detractors are at least partly right. Can we afford to take the chance? Can we gamble with future prosperity? Is the present tax system so bad that we must make an "all or nothing" throw of the dice? If the detractors of the White Paper are even partially right, its implementation could produce irreversible consequences which would lead Canada toward either economic stagnation or even greater governmental control of the economy. Because we are filled with the spirit of free enterprise, we find the second alternative every bit as distasteful as the first.

The architects of the White Paper, in inviting comment on its proposals, have asked for alternatives. The only alternative we feel at all competent to propose is that of caution and restraint. We look for evolution rather than revolution in our tax structure. We ask for phased introduction of tax reform in units that we can understand and assess rather than a radical parcel of proposals with interdependencies and ramifications upon which even scholars have been unable to find general agreement.

Our study of the White Paper has been further complicated through government statements of revision which have not been further explained. For example, we have been told that some way will be found to aid small corporations which will have lessened access to profits as expansion capital under the proposals. We have not been apprised of any firm device to accomplish this end, just hints that it is being investigated. The complexities of the White Paper are therefore compounded by the imponderables of later announcements. Together they have rendered the preparation of this brief a formidable task.

The authors of this brief claim no distinction as experts in tax law. Neither the writers themselves nor those they represent are accountants, lawyers or economists. We apologize

in advance for any inaccuracies this may have introduced into our brief and hope that the sincerity of our views will compensate in some measure for our lack of expertise.

CANADIAN RETAIL HARDWARE ASSOCIATION

Arthur J. Lochead, B.A.
President

Thomas M. Ross, B.Sc.Phm.,M.B.A.
Executive Director

TABLE OF CONTENTS

SECTION 1. INTRODUCTION

IDENTIFICATION OF THE CANADIAN RETAIL HARDWARE ASSOCIATION

1.1 The Canadian Retail Hardware Association is a non-profit corporation operated by and for the benefit of member hardware retailers from coast-to-coast in Canada who have voluntarily joined together for mutual benefit. The Association is not involved in commercial transactions related to the distribution of merchandise for resale by its members or others. The main areas of Association interest and service are developed around three aspects of dealer aid - education, communication and legislative representation. In addition, the Association makes a number of services available to its members through group financial participation. Among such services could be included group auxiliary health plans, life insurance plans, automobile leasing, mutual fund investment plan and many others.

1.2 The Association maintains a permanent office in Toronto, Ontario and is managed by a full-time professional staff operating under the direction of a Board of Governors which is elected annually by the membership. The Board numbers eleven persons, ten of which are practising hardware retailers who serve the Association without remuneration. The eleventh Board Member is the Executive Director of the Association who is the senior salaried employee of the Association.

1.3 Board Members are elected on a basis which provides both geographic representation and representation in proportion to membership strength in the various sections of Canada. The Board

SECTION 1. INTRODUCTION

IDENTIFICATION OF THE CANADIAN RETAIL HARDWARE ASSOCIATION

1.3

elects its own officers (President, Vice-President, and Honorary Treasurer) yearly from among its membership.

1.4 The Constitution of the Association, duly authorized by its membership, is attached to and becomes part of this brief as Appendix A.

1.5 Membership in the Association is open to all retail dealers who, in the opinion of the Board of Governors, provide hardware service to customers in their locality. Early in 1970, the Association had attracted a national membership of 1,388 hardware dealers.

1.6 Membership is not open to hardware departments of multipurpose stores such as department stores or discount houses.

MEMBERSHIP PROFILE

1.7 The Association conducts a survey yearly of the financial and operating results of its members. The latest survey covers operations during 1968 and is attached to this brief as Appendix B.

SECTION 1. INTRODUCTION

MEMBERSHIP PROFILE

1.8 The survey population in 1968 had average sales of $166,000.00 and the stores employed an average of 5.0 persons. We estimate, therefore, that the membership of the Association in 1968 accounted for total retail sales of over $230,000,000.00 and employed over 6,900 persons.

THE NATURE OF HARDWARE RETAILING

1.9 Our survey averages for 1968 indicate that in that year the average proprietor of a retail hardware store had a total return of $15,820.00 before taxes. This average dealer received a return of 13.3% on his investment in his business. Perhaps he is typical of a much larger population of small-to-medium-sized businessmen.

1.10 Canadian retail hardware outlets are predominantly independent, owner-operated units. With the extremely odd exception, it is a segment of industry which is completely Canadian-owned.

1.11 The owner-operators of hardware outlets perform a personal service for their customers and are active members of the communities they serve. The success of their business depends, to a great extent, upon the initiative and long hours of work which these proprietors invest for the reward of seeing their business develop and grow.

SECTION 1. INTRODUCTION

THE NATURE OF HARDWARE RETAILING

1.12 Independent retailing is a relatively high-risk occupation and hardware retailing is no exception to this rule. Financial rewards are not often proportionate to the investment risk as the average return of 13.3% on investment in our survey indicates. Often the only reward is in the independence afforded in working for oneself and in providing stable employment for employees who also depend upon the business for their living.

1.13 The independent hardware retailer operates in an environment of massive competition from the merchandising giants. Because he is determined to survive, he is a deterrent to retailing concentration in the hardware industry, but his effort usually far exceeds the forty-hour week.

1.14 Thus, we have a picture of the hardware retailer who serves his customers and community; provides employment; competes successfully in the face of strong and very capable mass merchandisers. It is not achieved without risk and devotion through long hours of hard work. The financial rewards are not compensation enough but he finds his satisfaction in other areas.

SECTION 2. THE CORPORATE TAX RATE

CATEGORIZATION OF CORPORATIONS FOR TAX PURPOSES

2.1 Underlying the White Paper proposals in the area of corporation tax, is a new method of categorization of corporations for tax purposes. This new system uses the character of the corporation (closely or widely-held) rather than its level of income.

2.2 We are distressed to see this aspect of the proposals defended so vociferously by the tax planners, and our distress is multiplied when we hear critics of the proposals often defend this point.

2.3 A progressive tax base is tied to the ability to pay and the basis of our individual taxation recognizes this rule. Why then should corporation tax be any different?

2.4 Present corporation tax is levied at a relatively low level on the first $35,000.00 of corporate profit and at a higher rate thereafter. This system recognizes that the corporation with large profits can afford to pay more tax than the small corporation. It seems to be progressive and fair to us.

2.5 The White Paper in its proposed categorization which affects tax credits of shareholders, differentiates between corporations solely on the basis of the character of the corporation with no regard to its size or earnings. This seems regressive and unfair to us.

SECTION 2. THE CORPORATE TAX RATE

CATEGORIZATION OF CORPORATIONS FOR TAX PURPOSES

2.6 It is important to note at this point that the United States levies a two-tier system of corporation tax (22% on the first $25,000.00 of profit and 48% thereafter) and that proposals for changing the United States Tax Act do not embrace the cancellation of this system. If the two-tier system in Canada is wrong, why isn't it considered so in the United States?

2.7 The White Paper proposals seem to testify that a corporation earning $5,000.00 can as easily afford 50% tax as a corporation earning $1,000,000.00. This is simply not true.

2.8 We are aware of the White Paper's view that the dual rate of corporate tax has been exploited by well-established and prosperous companies to avoid paying tax. We would suggest that ways be found to remedy this situation if it is considered undesirable without penalizing young, struggling, capital-hungry small and medium-sized businesses. It is ludicrous that the proponents of a single rate of corporate tax would use the argument of abuse to justify a system that would penalize honest taxpayers as well. As bad as the malady may be, small business cannot afford the cure.

2.9 The small corporation has many of the problems of the individual with low income. Meagre profits buy necessities rather than luxuries and outside capital is hard to attract because of the

SECTION 2. THE CORPORATE TAX RATE

CATEGORIZATION OF CORPORATIONS FOR TAX PURPOSES

2.9 (Continued....

relatively high risk. Unlike the low income individual, the small corporation doesn't have access to funds from welfare agencies when its need is great.

2.10 The present two-tier system of corporate tax based on corporate profit levels recognizes ability to pay which should always remain an objective of progressive taxation. It must be maintained.

SMALL BUSINESS EFFECTS

2.11 Before discussing the specific effects of the corporate tax rate proposals on small business, it is important to note that the owners of small businesses have always paid tax at roughly full personal tax rates when they removed the profits from the business. Currently, they pay the first installment as it were as a 21% corporate income tax. When they remove after-tax profits as dividends, they pay taxes at personal rates and receive a 20% dividend tax credit which almost compensates for the corporate tax paid earlier. So the second installment has been paid when the money was removed.

2.12 If the profits after corporate tax are left in the business indefinitely, then the second installment of tax is delayed indefinitely. Far from being inequitable, it is precisely this

SECTION 2. THE CORPORATE TAX RATE

SMALL BUSINESS EFFECTS

2.12

constant and continuing stimulus which has led small corporations to leave profits in the business year after year. It has stimulated the development of some of today's great corporations from rather modest roots.

2.13 The proposals contained in the White Paper allow closely-held corporation owners to be taxed at personal tax rates. If this option is accepted by the corporation owners, the ultimate impact of the tax will not change dramatically.

2.14 The critical difference between the present system and that contained in the proposals is that full tax at personal tax rates will have to be paid on all profits as they are realized by the corporation rather than when distributed to the owners. Under the proposals, there will be no opportunity to defer the payment of the second installment of tax until the profits are distributed to owners.

2.15 Generally, the small businessman will pay more taxes each year if he leaves his profits in the business by the amount that his marginal tax rate exceeds 21% (or 24% if the temporary surtax is considered).

SECTION 2. THE CORPORATE TAX RATE

SMALL BUSINESS EFFECTS

2.16 The dilution of profits through the proposed corporate tax will be much more than a slight increase. For example, a businessman having a corporate profit of only $12,000.00 a year could find his tax increased by 69%. A full $2,000.00 to which he previously had access for capital needs would be diverted in taxes. Table 1 indicates that if he enjoys $20,000.00 in yearly profits, the White Paper proposals could raise his corporate tax by over $3,900.00 - an increase in corporate taxation of 82%. (See Table 1)

2.17 The examples used in preparing our Table 1 are not extreme. They cover an area of income and profitability in which many of our members reside. Yet the table indicates a smallest corporate tax rise of 52% and increases range up to 108%. Such a tax structure, we believe, will effectively inhibit the development of new large corporations from modest beginnings.

INEQUITIES FOR SMALL BUSINESS

2.18 The inability to partially delay taxes on corporate profits will have its greatest effect on small businesses because all of their profits fall below the level where the present lower rate of corporate tax applies.

2.19 Small businesses rely heavily on profits to finance expansion and growth. The small corporation doesn't have access to sophisticated capital markets. The capital needs of small corporations are

TABLE 1.

CORPORATE TAX COMPARISONS

LEVEL OF CORPORATE PROFIT	PRESENT SYSTEM & RATES (21% PLUS 3% SURTAX)	WHITE PAPER ALTERNATIVES					
		CORPORATE TAX AT 50%			CORPORATE TAX AT PERSONAL MARGINAL RATE OF OWNER *		
		TAX	INCREASE IN TAX OVER PRESENT SYSTEM		TAX	INCREASE IN TAX OVER PRESENT SYSTEM	
$	$	$	$	%	$	$	%
4,000	960	2,000	1,040	108	1,459	499	52
8,000	1,920	4,000	2,080	108	3,072	1,152	60
12,000	2,880	6,000	3,120	108	4,877	1,997	69
16,000	3,840	8,000	4,160	108	6,720	2,880	75
20,000	4,800	10,000	5,200	108	8,717	3,917	82

* NOTE: For purposes of this calculation, it was assumed that the owner has a taxable income of $7,000 before the application of business profits. Tax has been calculated as tax payable over and above the tax on this first $7,000 of taxable income (ie: tax payable on business profits at marginal rates).

Based on combined Federal and 28% Provincial tax.

SECTION 2. THE CORPORATE TAX RATE

INEQUITIES FOR SMALL BUSINESS

2.19

served by the personal equity of the owners, after-tax profits and loan capital which is expensive because of the degree of risk. The owners' equity is limited and year-by-year growth has, of necessity, been financed out of after-tax dollars allowed to remain in the business.

2.20 The White Paper proposals will diminish the most important source of expansion capital available to the retail corporation. The corner hardware store can't sell stock to raise equity capital. He can't sell a bond or debenture at realistic interest rates. He must rely on profits and profits will be effectively drained away by the new tax structure. (See Table 1)

2.21 We believe the present tax structure to be equitable. The small corporation has partial tax deferral which compensates for his inability to attract outside financing. The White Paper for all its emphasis on equity fails to recognize the capital difficulties of small corporations and places them at a disadvantage through removal of this compensating privilege in tax structure.

2.22 There isn't the slightest doubt in our minds that the White Paper corporate tax proposals will inhibit the growth of small corporations. We suggest that this would be an accomplishment of doubtful merit.

SECTION 2. THE CORPORATE TAX RATE

INEQUITIES FOR SMALL BUSINESS

2.23 Of equal importance perhaps is that the present two-tiered corporate tax structure provides incentive for growth to the small corporation. If profits are left in the business, today's taxes at least are minimized. This incentive is important and we suggest has led to a considerable amount of expansionist activity in hardware retailing.

2.24 The White Paper in one stroke proposes to reduce both the ability to expand and the incentive to do so by small corporations.

2.25 The White Paper proposals, if implemented in their present form, will have the effect of changing the rules in the middle of the game for many hardware retailers. We have heard from many of our members who incurred inflexible long-term obligations upon entering the hardware business. These commitments are being retired, as the years pass, out of profits. They are uncertain as to their ability to continue if the rules are changed as contemplated.

2.26 We believe that it is reasonable to assume a certain degree of stability will be afforded by the government in its tax structure when entering long-term arrangements of this sort. Radical re-alignment may therefore be interpreted as a breach of faith.

2.27 As outlined earlier, the retail hardware business does not provide a return on invested capital which could be considered

SECTION 2. THE CORPORATE TAX RATE

INEQUITIES FOR SMALL BUSINESS

2.27

exorbitant by any measure. The opportunity to delay a portion of tax while a business and its functioning assets are enlarged has, to the present, provided a measure of compensation to new entrants to the trade. The White Paper's corporate tax proposals remove this entry initiative. New stores will not be established at the same frequency.

2.28 The hardware retailer who has laboured for many years building into his business his "estate" for retirement will not as easily find a buyer. A hardware store is not as easily sold as are shares in a giant corporation.

2.29 The lessening of independent entry initiative to hardware retailing will have many effects we believe. It will create extra hardships for those wishing to sell businesses and it will inevitably lead to a decreased importance of the independent sector of the industry. Retailing concentration in the distribution of hardware will result with control of distribution in fewer and fewer hands.

SMALL BUSINESS ADVANTAGES

2.30 Defenders of the White Paper have been quick to point out that shareholders of small corporations will have an important advantage over shareholders of large concerns in that they will receive 100% credit for tax paid by the corporation on their individual tax returns.

SECTION 2. THE CORPORATE TAX RATE

SMALL BUSINESS ADVANTAGES

2.30

By comparison, shareholders of the large firm will receive only 50% of the credit for tax paid. We would be less than honest if we didn't agree that this is an important advantage, but we would point out that it is by no means new. At present, shareholders of small firms receive a 20% dividend tax credit which almost compensates for the 21% corporate tax paid. The real beneficiaries of this provision will be shareholders of the large, closely-held corporations who will receive a tax credit equal to 100% of their cash dividend instead of the current 20%, with virtually no change in their corporate tax rate.

2.31 The proposal to allow closely-held corporations to be taxed at the individual tax rates of the owners (i.e. to be taxed as partnerships) gives this category of corporation a certain advantage over widely-held corporations. The advantage does not compensate for the removal of the 21% corporate tax however, because an individual would have to have a taxable income of $3,000.00 or less to obtain the same low rate of tax.

2.32 The partnership taxation option for small corporations introduces problems in itself, especially during the five-year institutional period of the higher rate of corporate tax. The option would need expert assessment each year by people who are retailers not tax specialists.

SECTION 2. THE CORPORATE TAX RATE

SMALL BUSINESS ADVANTAGES

2.33 If retailers wished to leave profits in the business, but at the same time take advantage of personal tax rates rather than the 50% corporate tax, they would have to enter into relatively complicated stock dividend arrangements. All in all, this would be much more complicated than the present system.

INFLATIONARY EFFECTS

2.34 There has been much debate over whether or not the White Paper proposals are inflationary. To the hardware retailer, the answer is clear.

2.35 Just as other people, the proprietor of a retail hardware store attains a certain standard of living. It is supported by the dollars left to him after corporate and personal income taxes. The White Paper proposals will increase his taxes dramatically but the pressure will remain to maintain his standard of living. He may divert dollars from the business which would further limit its expansion. It is inevitable that he would further expand profits through margin improvement in order to restore his after-tax profit position.

2.36 This process would invariably lead to higher retail prices for the goods and services offered in his establishment. There is no question that the corporate tax reform proposed in the White Paper would have an inflationary effect on retail prices.

SECTION 2. THE CORPORATE TAX RATE

COMPARISONS TO PARTNERSHIPS

2.37 The White Paper notes that its corporate tax proposals eliminate the distinction for tax purposes between closely-held corporations and proprietorships and partnerships. The authors of the White Paper indicate that this is just and equitable since closely-held corporations and these other forms of business compete on a similar scale.

2.38 The option of incorporation has always been open to proprietorships or partnerships if it was to their advantage for taxation purposes. Those organizations which wished to grow and had capital requirements beyond the assets of the proprietor or partners did incorporate in most cases in order to claim the advantage of being able to leave a larger proportion of profits in the business. The White Paper infers in its argument that the advantage was available to some while being denied to competitors. If this were true, it would have been admittedly shameful, but the inference was not and is not true at all.

2.39 The decision of a small business to incorporate or not has been voluntary. It has been accomplished in the vast majority of cases where expansion capital was required. There never has been a distinct tax advantage to incorporation for the business from which profits were stripped yearly.

SECTION 2. THE CORPORATE TAX RATE

COMPARISONS TO PARTNERSHIPS

2.40 We find it rather naive to read an assumption in the White Paper that small corporations compete with other small corporations and with proprietorships and partnerships. We doubt if this premise is correct in any area of small business endeavour but we can state categorically that it does not apply in retailing. Today's small or medium-sized retailer competes with the merchandising giants. He competes with every other retailer who sells the same merchandise and even competes for consumer spendable income with dissimilar retailers regardless of their size.

2.41 It is agreed that the proposals remove the distinction of small corporations and partnerships for tax purposes. We do not agree that this step provides equity in tax structure. It simply places a heavier tax load on small corporations in an expansion phase then they currently face. It puts the small corporation at a disadvantage in its competitive struggle with large merchandisers because of unequal opportunities for the attraction of capital.

2.42 One effect is a virtual certainty. The small corporations will grow less numerous simply because the greater part of the incentive to incorporate will have been removed.

SECTION 2. THE CORPORATE TAX RATE

DEPRECIATION RATES

2.43 The Minister of Finance has recently indicated that his Department will investigate the area of accelerated capital-cost allowances as an alternative to the expansion incentive for small corporations which is currently provided by the two-tiered corporate tax system. It is most difficult to comment in this area because no details have been released as to the possible or probable form such allowances may take.

2.44 There is no question in our minds that a system of accelerated capital-cost allowances available to small businesses would be most welcome and worthwhile. It also seems easily apparent that through the direct stimulation of expansion of small businesses, their prosperity would be served which in turn would ensure future tax revenues. We would support and endorse any proposal to stimulate expansion in this way.

2.45 We do not, however, consider that such a system would compensate small business for the higher rates of tax to which the White Paper would expose them.

2.46 Capital-cost allowances do not apply to the largest capital investment of an expanding retail business - its inventory. Accelerated write-off of fixed assets doesn't help enough in the purchase in the first place. The small business first must gather the capital for expansion and this is its greatest problem.

SECTION 2. THE CORPORATE TAX RATE

DEPRECIATION RATES

2.47 It is apparent also that accelerated capital-cost allowances are a relatively short-lived method of deferring tax when compared to the present corporate tax structure where the tax may be partially deferred indefinitely if the profits are left in the business to provide a continuous and important stimulus to expansion.

SECTION 3. THE CAPITAL GAINS TAX

3.1 Shares of incorporated hardware stores do not fluctuate in value with market conditions. When sold, the price does not ordinarily reflect anticipated future earnings or growth. The maximum selling price of a hardware store is represented by the book value and perhaps an amount for goodwill. Since the taxation of goodwill is considered separately in the White Paper, we can assume that any taxable capital gain must be related to the book value.

3.2 Book value of a hardware business is a combination of the owners' original investment (capital stock) and surpluses which have been built up in the business as years have gone by. The return of the owners' original investment certainly doesn't constitute a capital gain, so in relation to incorporated hardware stores we can equate the capital gains tax with a tax on the amount of surplus realized on sale - at least the amount of surplus which might have accumulated after the valuation day that the White Paper suggests.

3.3 It is impossible to comment further on the White Paper proposals for a capital gains tax without relation to the corporate tax proposals. The effect and weight of a tax on capital gains of hardware stores will be quite different depending on whether or not the proposed corporate tax changes are implemented.

3.4 If the White Paper proposals in the area of corporate tax are given the weight of law, the capital gains tax would be a further strong incentive for the incorporated hardware dealer to

SECTION 3. THE CAPITAL GAINS TAX

3.4

choose taxation as a partnership. If he was foolish enough to pay the corporate tax and not distribute the balance of profits to owners within the 2-1/2 year period allowed so that the owners could claim credit for the tax paid by the corporation, he would not only pay higher taxes as they were realized but would also become liable for capital gains tax on the profits remaining after the corporate tax when the business was sold.

3.5 In comparison, if the retailer distributed profits after tax either in cash or in stock dividends, he would probably pay a lower rate of tax at the time but he would avoid later capital gains taxes entirely. Under the profit-stripping arrangement, capital returned to the business (or left in if a stock dividend is declared) becomes a further owner investment from his after-tax dollars. No surplus is created and therefore no capital gains tax is payable when the business is sold.

3.6 The combination of corporate and capital gains tax proposals ensures that all small businesses will distribute profits yearly for tax purposes. The option to do this allowed in the White Paper is really no option at all - it is a certainty.

3.7 If the capital gains tax were imposed under present corporate tax law, its full weight would be felt by incorporated retail hardware stores. Profits left in the business to finance

SECTION 3. THE CAPITAL GAINS TAX

3.7

expansion and which appeared on the balance sheet as surplus would be fully taxed as capital gains when the business was sold.

3.8 The weight of the capital gains tax, whatever the corporate tax structure, would fall on those retail corporations which own the one fixed asset which can and does often appreciate in value - the store building and the land on which it is built. Any increase in value of this asset after valuation day would be subject to capital gains tax when it was sold.

3.9 We acknowledge that certain special provisions in the area of capital gains tax have been provided for closely-held corporations. They will not be forced to revalue their assets every five years and there will be no revaluation for capital gains tax when a family business is passed to heirs. While admitting the considerable benefit of these provisions, we should like to point out that the provision for no revaluation on passage to heirs has severe limitations.

3.10 Estate duties now have considerable weight in this country. Usually, an heir is left in the position of having to sell a portion of the business in order to meet these obligations. If this is done, capital gains tax immediately becomes payable and compounds the problem confronting the heirs. In another example, if the owner of a business is forced to sell for reasons of health and move to a warmer climate outside of Canada, he is faced with the capital gains tax.

SECTION 3. THE CAPITAL GAINS TAX

3.11 We are concerned also that capital gains tax is to be applied at full personal tax rates rather than at a lower rate as is in existence in the United States. In effect, because the capital gain of a retailer selling his store will come all at once, this provision decrees that the selling retailer will pay 50% tax on his capital gain. We consider this to be a severe deterrent to the accumulation of worth within a business. We are further disturbed that although the White Paper proposes the full weight of personal tax rates, it makes no provision for any credit in respect to taxes paid by the business over the years.

3.12 We should like to point out here that many retailers consider the equity they build up in their business to be their own personal retirement fund. While salaried employees invest in pension funds, the retailer considers that the sale of his business on retirement will provide him with funds for his declining years. Under current tax structure, the retailer has gained a measure of tax relief on funds left to build the business just as those with registered retirement savings plans are allowed tax relief on their deposits. However, under the proposed structure of corporate tax and capital gains tax, no tax relief on monies when put in or withdrawn from the business is possible. It will no longer be possible if the proposals become law to consider your business as your retirement plan.

SECTION 3. THE CAPITAL GAINS TAX

POSITION ON CAPITAL GAINS TAX

3.13 Earlier herein we have explained that the capital gains tax will only be felt by hardware retailers under present corporate tax structure and will be negligible if the White Paper proposals on corporate tax are adopted. In an earlier section of the brief, we have advised strongly against departure from the present two-tiered system of corporate tax. In combination, these factors suggest that we are prepared to accept a heavier weight of capital gains tax if present corporate tax structure is maintained.

3.14 Hardware retailers do not want a capital gains tax. This type of tax, however, is somewhat less noxious to them than the removal of the two-tiered corporate tax base.

3.15 If a tax on capital gains is implemented, we believe that the method proposed in the White Paper should be severely modified in order to prevent critical problems for small businessmen.

3.16 Capital gains tax should not be imposed at full personal tax rates but at some lower rate which recognizes that to a certain extent at least it is a tax on inflated values.

3.17 The surplus which builds up in small incorporated businesses represents profits on which corporate tax has been paid. No capital gains tax should be applied to such amounts when the business is sold.

SECTION 3. THE CAPITAL GAINS TAX

POSITION ON CAPITAL GAINS TAX

3.18 If a capital gains tax is applied, serious consideration should be given to allowing tax relief on capital deposited in the business much as is the case in registered retirement savings plans, since the business often constitutes a retailer's retirement fund.

3.19 In the case where a family corporation is passed to heirs, the government should consider allowing the heirs to pay estate duties over a prolonged period of years at nominal interest in order to prevent forced sale and burden of capital gains tax which in many cases would effectively prevent the heirs from continuing the business.

SECTION 4. EXPENSE ACCOUNT LIVING

CONVENTION EXPENSE

4.1 As an Association, we are concerned that the White Paper embodies in its discussion of Convention expenses the underlying philosophy that such meetings are wasteful in a business sense and are primarily geared to the pleasure and enjoyment of participants. We must strongly condemn this point of view and assert that it is false.

4.2 The language of the White Paper leaves grave doubts in definition. If the writers of the proposals include association-sponsored seminars and training courses within their definition of "Conventions and similar meetings", then they are even more dangerously wrong in their assessment.

4.3 This Association has an annual Convention. For those attending, it is not a pleasure trip. While it is true that an annual Banquet and Ball is held on one evening, it is also true that the daylight hours are filled with business-related activity, and another evening is devoted to the Association's Annual General Meeting.

4.4 In addition, the Association organizes management development seminars for its members. The courses offered are of a week's duration and registrants are exposed to seventy hours of instruction in the seven-day period. They also find it necessary to spend evening hours preparing reports and assignments for the next day. Members attend these courses at considerable cost to their businesses and there is no social aspect whatever to their attendance.

SECTION 4. EXPENSE ACCOUNT LIVING

CONVENTION EXPENSE

4.5 We believe that if participants in either our Convention or seminar programmes were forced to assume the cost from after-tax dollars, they would be somewhat discouraged from attending and from improving themselves through such attendance.

4.6 Further, we believe that these proposals within the White Paper are grossly discriminatory toward independent businessmen. They would remove the right of the independent to improve himself through exchange of ideas and experience as a legitimate expense of his business. The same right is not refused to chain operators who may gather individual store managers in internal business or educational sessions.

4.7 We suggest that these proposals would have a very serious effect on the continued operation of trade or professional associations. We object most strenuously to the proposals and to the philosophy which seems to underlie them.

4.8 We are aware of and endorse completely the submission of the Institute of Association Executives concerning this topic.

VEHICLE STAND-BY CHARGE

4.9 The White Paper proposes to institute a minimum stand-by charge for the use of a company vehicle to businessmen who drive the vehicle to and from their place of employment.

SECTION 4. EXPENSE ACCOUNT LIVING

VEHICLE STAND-BY CHARGE

4.10 We are aware that the use of company-owned vehicles has created difficulties in the past for the tax department which has had to rule individually in many separate cases. It would be nice if this area of tax law could be reduced to a simple formula. We believe, however, that circumstances vary so much from one case to another that there is no alternative to individual consideration of specific cases.

4.11 Insurance sources advise us that in many cases insurance rates on company vehicles would increase if they were to be left unattended in commercial areas at night and over weekends. Is the businessman to be penalized for driving a company vehicle to his residence more for its protection than for his own convenience? This is not an isolated case. Many hardware dealers live within easy walking distance of their stores but remove their business vehicle to their residence at night for its protection.

4.12 Many hardware dealers have an automobile for their personal use as well as a company vehicle. The second vehicle is required by the business and would not be existent otherwise. We believe that in such cases the business vehicle is a logical expense of the business whether or not it is driven home by the owner.

SECTION 5. CO-OPERATIVES

5.1 In many locations in Canada, independent hardware retailers compete with consumer co-operatives in the sale of their normal stock-in-trade. It has always seemed incongruous to these dealers that the stores competing with them were afforded vast tax advantages simply because they were organized as consumer co-operatives. The advantages afforded co-operatives have stimulated phenomenal growth of these outlets over the years.

5.2 In the belief that an equitable tax system requires that it treat competing outlets equally, the Association has long petitioned the government for necessary revision to the Income Tax Act to bring this about. We have actively supported the efforts in this area of the Equitable Income Tax Foundation.

5.3 We were somewhat heartened to see that the White Paper proposes the elimination of one of the tax advantages enjoyed by co-operatives and proposes to compromise another.

5.4 The White Paper proposes to remove the existing three-year income tax exemption for new co-operatives and in this we heartily agree.

5.5 The White Paper also proposes to raise the limit on deductibility of patronage dividends before tax from the present minimum of 3% of capital employed to a somewhat higher rate which would vary with the interest rate on government bonds. We applaud this intent which certainly will lessen the tax advantage now enjoyed

SECTION 5. CO-OPERATIVES

5.5

by co-operatives. At the same time we must admit to some disappointment that the inequities have not been removed in the proposals altogether.

5.6 The White Paper recognizes that inequities exist in the taxation of co-operatives in comparison to directly-competing, normally-incorporated businesses. We question the logic of acting to reduce the inequities rather than to remove them completely under these circumstances.

5.7 The Association and its members stand inalterably opposed to income tax concessions for co-operatives in any degree. We endorse and support the brief of the Equitable Income Tax Foundation on this subject.

SECTION 6. INVESTMENT INCOME OF ASSOCIATIONS

6.1 The White Paper proposes to tax at full rates the investment income of non-profit organizations such as Associations. As might be expected, we are opposed to such a move.

6.2 By their very nature, non-profit organizations exist only to serve their members. Investment income is a necessary part of their revenue flow and taxation of this income source would directly compromise the ability of an Association to serve its members.

6.3 The revenue stream of Associations comes at one point in the year when dues are collected from members. This revenue is expended over a twelve-month period and investment income from its short-term use augments its effect when translated into member services.

6.4 Many Associations maintain reserves against a sudden decrease in income or in order to provide for unanticipated emergency expenditures. These funds also are invested and the income derived joins the current income stream.

6.5 This Association received investment income during 1969 of about $8,000.00. The year ended with an overall surplus of less than $1,000.00. If we had been forced to pay tax at corporate rates on our investment income as proposed by the White Paper, we would have either ended the year with a deficit of $3,000.00 or would have had to compromise our membership services.

SECTION 6. INVESTMENT INCOME OF ASSOCIATIONS

6.6 Labour unions and religious organizations have been exempted from this provision in the White Paper. We find it difficult to understand why the White Paper would propose taxation of investment income of employer groups while exempting employee organizations such as labour unions. We submit this to be inequitable in itself.

6.7 Associations being non-profit in nature are not required to pay tax. It follows from this that they may not be able to charge the cost of their investment programmes to the income produced before tax.

6.8 We fail to understand the logic of requiring any organization to pay tax on one portion of its income regardless of the overall profitability of that organization.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

7.1 The independent hardware retailer would be affected in many ways by the proposals contained in the White Paper. Many of the proposals will require him to pay more taxes.

7.2 Because he is usually in the middle-income bracket, he will pay a higher rate of personal income tax just as will everyone in the same tax category.

7.3 If he is incorporated, because his is a small corporation, he will pay corporation taxes at a much higher rate.

7.4 He will meet a capital gains tax when he sells his building, if he owns it, and will pay this tax when he sells his business to other than his family, or maybe even then if part of the business must be sold outside to pay gift taxes. If he is forced to leave the country for health reasons, he will meet capital gains tax before he goes.

7.5 He will suffer from the loss of allowable business deductions for such things as his attendance at Conventions or, if he drives a business vehicle, home from work.

7.6 The incorporated hardware retailer just happens to be in a class and occupation which is particularly hurt by a number of the White Paper provisions. The effect of any one of them would be serious enough; in combination they could be crippling.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

7.7 Table 2 outlines, through use of common examples, the weight that will fall on the retailer when higher corporate tax rates and higher personal rates are combined. A single man operating a hardware store and previously leaving after-tax profit in his business will pay over $3,000.00 more in taxes each year (an increase of 52%) if he takes a salary of $10,000.00 and the business earns $15,000.00 in profit. If he is married with two dependant children, his tax will increase by almost $2,600.00 or 48%. (Table 2) We emphasize that these almost incredible-sounding increases are not extreme examples. They represent many stores in our membership.

7.8 At the same time that the White Paper proposals are being discussed, the hardware retailer is meeting increases in property taxes and business tax. Provincial governments which have not yet entered into the income tax field are threatening to do so. He is wondering how he will meet the prohibitive gift and estate taxes introduced by the Federal Government a year ago when he finally passes the business on to his heirs. The tax changes proposed in the White Paper aren't all he has to worry about in the tax field.

7.9 The combined effect of White Paper proposals on the hardware dealer may best be explained in respect to the problems they will create for him.

TABLE 2.

EXAMPLES OF THE COMBINED EFFECT OF CORPORATE AND PERSONAL TAX RATE INCREASES ON THE SMALL BUSINESSMAN

SALARY	CORPORATE PROFIT	COMBINED PERSONAL AND CORPORATE TAX (FEDERAL TAX PLUS 28% PROVINCIAL TAX)				
		PRESENT SYSTEM AND RATES		PROPOSED SYSTEM AND RATES CORPORATE PROFITS TAXED AT INDIVIDUAL MARGINAL RATE		
		(A) CORPORATE PROFITS LEFT IN BUSINESS	(B) CORPORATE PROFITS REMOVED AS DIVIDENDS		INCREASE OVER COLUMN A	
$	$	$ TAX	$ TAX	$ TAX	$	%
SINGLE TAXPAYER - NO DEPENDANTS						
10,000	5,000	3,429	3,996	4,372	943	28%
10,000	10,000	4,629	6,056	6,574	1,945	42%
10,000	15,000	5,829	8,234	8,878	3,049	52%
10,000	20,000	7,029	10,413	11,405	4,376	62%
MARRIED MAN WITH TWO DEPENDANT CHILDREN						
10,000	5,000	2,964	3,383	3,590	626	21%
10,000	10,000	4,164	5,319	5,652	1,488	36%
10,000	15,000	5,364	7,493	7,956	2,592	48%
10,000	20,000	6,564	9,671	10,381	3,817	58%

NOTE: All allowable standard deductions are taken into account in calculating personal taxable income. The 1969 tax reduction, old age security tax and temporary surtax are also included in figures denoting present tax levels.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

CAPITAL GENERATION

7.10 The corporate tax proposals will prevent him from gaining access to as large a proportion of profits as formerly to provide for expansion of his business. What other source of capital is available to him? He is being told that he must pay taxes at the same rate as large corporations (or at least at a much higher rate than at present if he chooses to pay tax at his personal marginal rate), and yet he doesn't have the same access to outside capital that the large corporations do.

7.11 He is condemned to a slower rate of growth or even to none at all if previous profits have allowed only slow expansion. In some cases he will even have trouble living up to prior long-term commitments that he entered into under an older less prohibitive tax structure.

INCENTIVES

7.12 Not only the means to expand, but also the incentive to expand will have been removed from him because there will be no tax advantage to leaving capital in the business. Only the most determined will try to improve his business within such an atmosphere.

7.13 The incentive for young people to enter the retail business world will also be severely crippled. Where will the next generation of hardware people come from? The risks are too high and the hours too long in the retail trade to make it attractive without financial incentives.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

COMPETITIVE CONDITION

7.14 The death of the two-tiered system of corporate tax will rob the small retailer of his largest single advantage in the competitive struggle with the merchandising giants. Indeed, he will be put to a competitive disadvantage with those who can attract capital.

7.15 In order to replace profits now confiscated through taxation, he may be compelled to raise the prices at which he sells his merchandise. This then provides a further competitive disadvantage and the slide to bankruptcy has begun.

7.16 The retail hardware business is very highly competitive and the competition is provided by large merchandising concerns. Many dealers who have so far withstood competitive pressures will no longer be able to do so. We do not say this idly. There is no doubt in our minds that the White Paper proposals will tip the delicate competitive scales in favour of large multi-unit merchandisers. Those who now are barely able to keep up will close their doors.

7.17 The ultimate result will be an accelerated trend toward the concentration of retailing power in fewer and fewer hands. It is a prospect which leaves little cheer in our hearts.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

HIS "ESTATE"

7.18 The retailer who invests in his business expecting the sale of the business to provide his retirement funds will cease to exist. If the proposals become law, he can no longer afford to operate in this way.

7.19 On the sale of his business, he will have to pay capital gains taxes because he has been imprudent enough to leave profits in the business for more than 2-1/2 years even after paying corporation tax at a rate of 50%.

7.20 Perhaps more important, to whom will he sell the business? Where will he find a younger person willing to invest his savings at a relatively high degree of risk and willing also to work the long hours necessary to make a success of a retail trade? Where will he find someone to do all this; be content with a low return on investment and pay the same rate of taxes as if he were working for somebody else?

7.21 The White Paper proposals will make it increasingly difficult to sell hardware stores (it's even very difficult now) with the result that many businesses will retire with their owner.

HIS "LEGACY"

7.22 The estate taxes and gift taxes introduced a year ago have made it difficult to pass a business from one generation to the next.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

HIS "LEGACY"

7.22 (Continued....

This has been particularly difficult for businesses which will be passed over in this decade because the provision to pay estate taxes which has been planned perhaps for many years suddenly became inadequate a year ago.

7.23 Even now, an increasing number of family heirs are being forced to sell a business that has been in the family for generations in order to pay the estate duties that are currently required.

7.24 Just a year later, the White Paper proposals suggest that the rules be changed again - and again they will compound the problem in turning over family businesses.

7.25 The capital gains tax will not take effect unless there is a sale outside of the family. The new estate duties almost ensure that there must be a sale outside the family in order to raise the cash for the estate or gift tax. With the sale, capital gains tax must be paid, so the one stimulates and compounds the problem of the other.

7.26 The higher corporate tax rate on small business will greatly inhibit heirs from using profits to pay back the portion of the business or capital of some kind drained off in the transfer between generations.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

HIS "LEGACY"

7.27 Many family businesses will terminate with the present generation if the proposals become law.

HIS "ECONOMY"

7.28 The hardware retailer will fight to preserve his standard of living. One of his weapons will be higher selling prices in his attempt to replace funds through higher margins drained off by taxation.

7.29 Other retailers undoubtedly will react to the same pressures in the same way. The result will be an inflationary spiral to which we can see no alternative.

7.30 We are not economists but we think we know retailers. It doesn't take an economist to predict the outcome of rising prices. We are in no doubt at all that the White Paper tax proposals are inflationary in the extreme.

HIS ENLIGHTENMENT

7.31 Hardware dealers as well as other independent businessmen will be discouraged by the proposals from seeking to better themselves and sharpen their art through attendance at Conventions, Seminars and the like.

SECTION 7.

HIGHER TAXES AND THE HARDWARE RETAILER

HIS ENLIGHTENMENT

7.32 The White Paper tells him that such activity is wasteful and it would require him to pay his way out of after-tax dollars.

7.33 This Association has spent a good proportion of its efforts in convincing hardware dealers to get out of their stores; to see; to learn and to compare. We have seen it work to improve the efficiency of individual retail units.

7.34 The proposals are now to stimulate the opposite. We sincerely believe this attitude to be extremely foolhardy.

SECTION 8. A NOTE ABOUT EQUITY

8.1 The authors of the White Paper make constant reference to equity in the tax structure when defending their proposals. We feel constrained as a result to comment on this phase of the White Paper within this brief.

8.2 We do not feel that the White Paper proposals in some critical areas are equitable. On the contrary, we detect a bias in the document against the small businessman. We suggest that there are many evidences of such a bias.

8.3 The White Paper admits the need for a progressive individual tax rate and yet it proposes to tax the "poor" corporation at the same rate as the "rich" one. It proposes to upset competitive balances by introducing proposals which hit small businesses much harder than the large. It proposes to disallow expenses which the independent businessman undertakes to improve himself. It introduces a tax on employer associations (investment income) which is not levied on employee groups. It proposes to confiscate a larger proportion of small business profits when these are their only source of expansion capital. Its proposals will make it increasingly difficult for small businesses to be sold or passed to heirs, particularly when combined with earlier gift and estate tax increases. It grossly changes the rules for small business as far as tax matters are concerned leaving them with long-term prior obligations that will be difficult to fulfill. Most important of all, it effectively cripples the initiative which is required in the high-risk, large-effort area of small business. Finally, it recognizes the inequity of tax concessions afforded co-operatives but still leaves them in a favoured position.

SECTION 8. A NOTE ABOUT EQUITY

8.4 All of this it accomplishes surprisingly, under the mantle of "equity". We do not accuse the authors of the White Paper of being knowingly biased against small business. Rather, we suggest that they are not aware of the special needs of this group if it is to survive in a viable form in our economy.

8.5 Our impression is that the proposals were drafted to fulfill criteria associated with large, widely-held corporations by men who understand business on that scale. Once the plan was created, small business was molded to fit its precepts.

8.6 There are critical differences stimulated by the scale of businesses. These differences have their roots in such things as competitive position and access to capital. The differences are dramatic enough that they defy attempts of relating one to another.

8.7 A tax system which is just and equitable for one scale of operation can be blatantly unjust and inequitable at the other end of the scale. We believe the White Paper on Tax Reform to be a classic example of this theory.

8.8 While the White Paper may be equitable for some or even many groups within the population, we believe it to be grossly inequitable toward the small businessman, which group includes the hardware retailers of Canada.

SECTION 9.

A SUMMARY OF RECOMMENDATIONS

9.1 The Canadian Retail Hardware Association begs to present the following recommendations in respect to the proposals contained in the White Paper on Tax Reform:

9.2 That the government abandon thoughts of dramatic change of a tax system that has served the country remarkably well, and proceed with orderly and cautious tax reform in order to preserve the stability of the economy and the balances within it while gradually serving the needs of the day.

9.3 That the proposal to eliminate the present two-tiered system of corporate taxation be abandoned and that a preferential corporate tax rate on the first $35,000.00 of corporate profits be retained as essential to the growth, incentive, viability and competitive position of small, relatively high-risk businesses.

9.4 That the categorization of corporations for tax purposes as closely-held and widely-held, regardless of scale or level of profits, be abandoned as regressive, and that the present progressive categorization based on level of corporate profits be maintained.

9.5 That accelerated capital-cost allowances for small businesses be considered and implemented as a needed stimulus to small business expansion.

SECTION 9.

A SUMMARY OF RECOMMENDATIONS

9.6 That the rate of taxation applied to capital gains be substantially lower than the personal marginal tax rate in recognition of the fact that, to some extent, it is a tax on inflated values.

9.7 That capital gains tax be not applied to surpluses of small businesses on their sale in recognition that the surplus is generated from tax-paid profits.

9.8 That if the preferred tax rate on the first $35,000.00 of corporate profits is removed, owners of small businesses be allowed to gain tax relief for monies left in the business in much the same manner as deposits in registered retirement savings plans are exempt from tax, in recognition of the fact that the business is often the sole source of retirement capital for small businessmen.

9.9 That capital gains tax not be applied on the sale of a business within a family if the original owner is forced to leave Canada for valid medical reasons.

9.10 That transfers of family businesses between generations be eased by the provision of low-cost government loans to allow the second generation to cover estate or gift tax without resorting to sale of the business.

SECTION 9.

A SUMMARY OF RECOMMENDATIONS

9.11 That the proposal to disallow the cost of attendance at Conventions and Seminars as a legitimate expense of a business before tax be abandoned and the privilege of deducting such items from personal taxable income be allowed for employees in recognition that such expenses contribute to the knowledge and expertise of both the owner of a business and his employees.

9.12 That the proposal to impose a minimum stand-by charge on all businessmen who have minimal access to use of a company vehicle be abandoned in favour of individual rulings in each case in order to prevent penalizing those who use the vehicle other than by their own choice.

9.13 That the proposals to remove certain of the tax advantages enjoyed by co-operatives be extended to remove all advantages in recognition that co-operatives serve the same markets and compete directly with other types of business organizations.

9.14 That the proposal to tax investment income of associations and other non-profit groups while exempting labour unions and religious organizations be abandoned, but failing this, be applied equally to all non-profit organizations.

9.15 That the government seek more meaningful dialogue on tax reform through its introduction in easily understandable units rather than the introduction of a complicated set of inter-dependent proposals toward which even tax experts cannot find general agreement.

SECTION 9.

A SUMMARY OF RECOMMENDATIONS

9.16 That the government assure the people of Canada of some stability in tax structure within which businessmen and individuals may confidently plan necessary or desired long-term commitments in recognition of the fact that turmoil in the tax structure causes severe hardships for those who have entered such agreements.

9.17 That the government clearly and concisely outline its need for an ever-increasing proportion of the Gross National Product of Canada whenever tax increases are proposed or implemented.

All of which is respectfully submitted

CANADIAN RETAIL HARDWARE ASSOCIATION

* * * * *

APPENDICES

APPENDIX "A"

CONSTITUTION

of the

CANADIAN RETAIL HARDWARE ASSOCIATION

Article I. GENERAL

1. The name of this Association shall be the CANADIAN RETAIL HARDWARE ASSOCIATION (ASSOCIATION CANADIENNE DES DETAILLANTS EN QUINCAILLERIE), hereinafter referred to as the Association.

2. The seal, an impression whereof appears on the margin hereof, shall be the official seal of the Association.

Article II. OBJECTS

1. The objects of this Association shall be to promote the interests of those engaged in the retail hardware business; to disseminate information with respect to the retail hardware business and the merchandise appertaining thereto; to encourage the development of uniformity and certainty in the customs and usages of the trade; to foster friendly intercourse between retail hardware merchants by the establishment and extension of a more intimate acquaintance among the members of the Association; to furnish statistical information to its members on matters relating to the trade; to study the retail hardware merchants' economic function in the nation and to make available to its members from time to time information as to the changing business conditions and methods with a view to increasing the efficiency of hardware retailing; to promote and cultivate friendly relations with manufacturers and wholesale hardware dealers and to give expression at the various governmental levels to the views of retail hardware merchants throughout the nation.

Article III. MEMBERSHIP

1. Classes of Membership.

A. Active Members. Active Membership in the Association shall be open, upon application on approved form and following payment of the annual fee as shall from time to time be determined, to all proprietorships, firms or corporations engaged in Canada in the retail hardware business and who, in the opinion of the Board of Governors of the Association, are providing the consuming public with adequate service in the retail hardware field, and any such proprietorship, firm or corporation is hereinafter referred to as an establishment.

A membership card shall be issued to each active member establishment and the possession of such card by an individual shall be considered full and final evidence of his right to vote at meetings of the Association or to serve as a member of the Board of Governors thereof as the duly authorized representative of the member establishment.

A new card will be issued by the Association upon receipt by the Executive Director of a request in writing from the principal officer of the member establishment. The issuance of a new card will render the original card null and void.

B. Associate Members. Associate Membership in the Association shall be open, upon application on approved form and following payment of the annual fee as shall from time to time be determined by the Board of Governors, to clerks or employees of member establishments; to retired personnel who, prior to retirement, were proprietors or employees of active member establishments; to executives and salesmen representing either manufacturers or wholesale dealers whose goods are normally carried in retail hardware stores; and to those employed in an editorial or executive capacity by trade magazines devoted, in whole or in part, to a branch of the hardware industry.

Associate members shall be entitled to certain privileges, such as attendance at public meetings of the Association and at hardware shows or displays held by the Association as well as other privileges that shall from time to time be stipulated by the Board of Governors, but shall not be entitled to vote at meetings of the Association or to hold office therein.

C. Honorary Life Members. Honorary Life Membership in the Association may be granted, at the full and final discretion of the Board of Governors, to the voting representative of any active member establishment or to an associate member who at one time had been the voting representative of an active member establishment, in recognition of important and distinguished service on behalf of the Association or its members.

An Honorary Life Membership card shall be issued to such individuals which will entitle them to certain privileges of the Association, including that of voting, without the payment of annual membership fees and, so long as the Honorary Life Member is actively engaged in Canada in the retail hardware business, shall entitle the establishment with which he is connected to the full service of the Association and entitle the Honorary Life Member to hold office therein.

D. Honorary Members. Honorary Membership in the Association may be granted, at the full and final discretion of the Board of Governors, to any person save those to whom Honorary Life Membership is open, in recognition of important and distinguished service on behalf of the Association or its members.

Honorary Members shall enjoy no voting privileges and shall not be eligible for office in the Association.

Honorary Membership shall not confer any privileges upon any establishment with which the Honorary Member may be employed. Persons so honoured shall not be required to pay any annual membership fees.

2. Discipline of Members. The Board of Governors may suspend for a period, or expel from the Association Membership, any member establishment or individual member, regardless of class of membership, because of:

(a) being guilty of any conduct unbecoming to a member;

(b) making a general assignment for the benefit of creditors, or if a receiving order under the Bankruptcy Act is made against the member;

(c) failure to pay dues after receiving due notice.

Article IV. AFFILIATE ASSOCIATIONS

1. The Association may affiliate with any Trade Association with the approval of the Board of Governors.

Article V. MEETINGS

1. The annual meeting for the report of the results of the election of the Board of Governors and for the reception of reports and transaction of general business shall be held each year during the period January 1 to April 30 inclusive, at a time and place to be designated by the Board of Governors.

2. A quorum for the transaction of business at any general meeting of the Association shall consist of twenty-five voting delegates present in person.

3. At the annual meeting of the Association there shall be included, in addition to any matters initiated by the Board of Governors, a report by the Honorary Treasurer on the Financial Statement.

4. Delegates of Active Member establishments and Honorary Life Members only shall be entitled to attend and vote at all general meetings of the Association, called for the conduct of Association business.

5. Any group of 25 or more Active and/or Honorary Life Members may request the Board of Governors to submit a referendum by mail to the membership concerning any issue or matter relating directly or indirectly to the interests and objects of the Association and its members, and the Board of Governors shall submit such referendum to all Active and Honorary Life Members accordingly and report to the membership on the result of the same. Any such request shall be in writing and signed by each of the 25 members.

6. Special general meetings of the Association may be called at any time on order of the Board of Governors and a special general meeting shall be called by the President on the written request of fifty active and/or Honorary Life Members in good standing. Notice of the annual or of any special general meetings of the Association shall be given in writing by the Executive Director at least thirty days prior to the date of such meeting, and such notice shall be sufficiently given by mailing such notice in a prepaid wrapper addressed to the eligible members at the addresses shown on the membership list of the Association.

Article VI. BOARD OF GOVERNORS

1. Powers of Board. The administration of the Association shall be vested in a Board of Governors of whom all but the Executive Director shall be delegates of Active Member establishments in good standing.

The Board of Governors of the Association may from time to time:

(a) borrow money,

(b) issue, sell or pledge securities of the Association,

(c) charge, mortgage, hypothecate or pledge all or any of the real or personal property of the Association including book debts and unpaid membership dues, calls, rights, powers and franchises to secure any such securities or any money borrowed, or other debt or obligation of the Association.

2. Term of the Board. The Board of Governors shall take office annually on the day following the conclusion of the annual "Hardware and Housewares" Show sponsored by the Association, or on the day following the Annual General Meeting of the Association, whichever shall be later, and shall continue in office until the corresponding day of the following year and until their respective successors are elected or appointed.

3. Composition of Board. The Board of Governors of the Association shall number eleven persons as hereinafter set out:

A. The Executive Director who shall be appointed as set out in Article VII following.

B. One representative from each of five electoral district shall be elected to the Board annually, subject as herein otherwise provided. These districts shall be defined as follows:

District 1. British Columbia and Yukon.

" 2. Prairie Provinces and North West Territories.

" 3. Ontario.

" 4. Quebec.

" 5. Atlantic Provinces.

C. The remaining five positions on the Board shall be annually filled by election based on the approximate active membership in the Association in each electoral district, subject as herein otherwise provided.

The Board shall annually, at the Annual Board Meeting, designate the apportionment of these five seats between the five electoral districts for the Association year commencing with the next Annual Meeting based on active membership figures at the time of the Annual Meeting at which such apportionment is made. At the same time, for those electoral districts granted multiple representation through the provisions of clauses B and C as herein set out, the Board shall designate electoral sub-districts to each of which single representation will be granted and each of which will be approximately equal in active membership.

D. Notwithstanding the provisions of clauses B and C above, the Immediate Past President, the President, the Vice President and the Honorary Treasurer of each Board shall not require election to the next succeeding Board but shall be deemed to be representatives from their respective electoral districts or sub-districts as set out in clauses B and C above.

4. Election of Board. Nominations for membership in the Board of Governors shall be in writing and may be forwarded by an active member or Honorary Life Member to the Executive Director by mail so as to reach his office not later than sixty days prior to the Annual General Meeting, any such nomination to be accompanied by the written consent of the nominee to his nomination, upon form approved by the Board of Governors.

Active members and Honorary Life Members shall be sent ballots by mail at least thirty days prior to the Annual General Meeting, giving the names of the candidates in the district or sub-district in which the member is located, including those nominated as above provided and the one nominated by the Nominating Committee as hereinafter provided, and each Active Member or Honorary Life Member of the Association shall be entitled to vote for one candidate in the electoral district or sub-district in which the member is located. The ballots shall be returned so as to be received not less than fourteen days prior to the Annual General Meeting to an independent scrutineer designated by the Board of Governors in the notice to the electors accompanying the mailing of the ballot to the Active Members or Honorary Life Members.

The candidate having received the highest number of votes in an electoral district or sub-district shall be deemed elected for that district or sub-district.

In the case of an equality of votes for any two or more candidates for any electoral district or sub-district for election as a member of the Board of Governors (no person having received a higher number of votes in that electoral district or sub-district) the President shall have the authority to decide and shall decide, by a casting vote, which of the said candidates shall be elected, and the candidate for which the President so votes shall be conclusively deemed elected accordingly. When such a vote is required, the independent scrutineer shall seek and obtain the President's casting vote in private and such vote shall be recorded in the manner of all votes with the casting vote not recorded separately nor shall the obtaining of such vote be recorded.

5. Meetings of Board. The Board will meet regularly twice a year as follows:

   A. The Annual Meeting of the Board will be held at the time and place of the Annual General Meeting as provided in Article V (1) above.

   B. The Semi-Annual Meeting of the Board will be held each year during the period July 1 to October 31 inclusive, at such time and place as designated by the Board.

6. Quorum of Board. The quorum for the meetings of the Board of Governors shall be a majority of the qualified members of the Board of Governors holding office from time to time who shall be present in person at the meeting.

7. Voting of Board. At meetings of the Board, a simple majority vote of Governors in attendance will be deemed conclusive.

The Chairman shall only vote in the event of a tie vote of the Governors and, in this case, the Chairman's vote will be deemed conclusive.

Between meetings of the Board, questions may be referred to all members of the Board, either on authority of the Executive Committee or of the Executive Director in the form of a prepaid postal wrapper and containing a ballot slip for return. A majority vote of the Board through returned ballots shall be required in order to consider the vote conclusive and all matters so decided shall be further ratified by the next regular meeting of the Board.

8. Vacancies on Board. In the event that vacancy shall occur on the Board of Governors by reason of the death or resignation of a member of the Board, or by reason of a member of the Board having ceased to be qualified so as to serve pursuant to the provisions of Article III above, the Board of Governors may appoint a member who is so qualified to fill such a vacancy for the balance of the term of office of the Board, provided that the member so appointed is from the same electoral district or sub-district as that in which the vacancy occurs. If, however, the vacancy shall relate to a member of the Board of Governors who is a member ex-officio by reason of his being the Immediate Past President or his Immediate Predecessor of the Association, the person appointed in his place and stead shall be a Past President of the Association who is still actively engaged in the retail hardware business. If the vacancy shall relate to the Executive Director, the Board of Governors may appoint another person to the post or act temporarily to appoint an employee of the Association as Chief Administrative Officer who shall perform all the functions of the Executive Director without membership on the Board.

9. Remuneration of Board. With the exception of the Executive Director, members of the Board of Governors shall receive remuneration for expenses as stipulated from time to time by the Board of Governors and approved by the Annual General Meeting. The Executive Director shall be remunerated as set out in Article VII following.

Article VII. OFFICERS

1. The Officers of this Association shall consist of an Immediate Past President, a President, a Vice President, an Honorary Treasurer and an Executive Director.

2. The Immediate Past President shall be the person who most recently has completed a term as President of the Association. He shall not require election or appointment and shall serve as a member of the Executive Committee. In addition, the Immediate Past President shall serve as Chairman of all meetings of Past Presidents which may from time to time be called and shall act as the representative of all Past Presidents on the Board and Executive Committee. Only persons qualified from time to time to have served as Immediate Past President through the completion of a Presidential term will be considered as Past Presidents of the Association.

3. The President shall be the person who most recently has completed a term as Vice President of the Association. He shall not require election or appointment and shall serve as a member of the Executive Committee. He shall be the chief elected officer of the Association and shall be responsible for giving leadership in matters of policy on behalf of the Association and shall, when present, preside at all meetings of the Association and of the Board of Governors and of the Executive Committee. The President shall appoint such standing committees as he shall deem wise for the purpose of conducting

special investigations or for the supervision of special activities of the Association and shall delineate the powers of such Standing Committees which, in all cases, shall be limited to the making of recommendations to the Board of Governors.

4. The Vice President shall be the person who most recently has completed a term as Honorary Treasurer of the Association. He shall not require election or appointment and shall serve as a member of the Executive Committee. The Vice President shall assist the President in the exercise of the duties of the President and in the temporary absence or disability of the President, the duties of the President shall be discharged by the Vice President.

5. The Honorary Treasurer shall be elected annually by the Board of Governors from among the members of the Board of Governors who have been elected by their constituents. The Honorary Treasurer shall be the chief financial officer of the Association. He shall be responsible for the maintenance of proper books of accounts which shall be audited at least once each year and at any additional time or times if required by the Executive Committee and shall report to the Board of Governors at each regular meeting as to the financial position of the Association and shall make recommendations on matters affecting the finances of the Association. At the Annual Meeting of the Association the Honorary Treasurer will submit an audited report covering the financial transactions of the Association during the preceding fiscal year, copies of which audited report shall be made available two weeks in advance of the annual meeting to active members in good standing, who request same in writing.

6. The Executive Director shall be a full-time salaried officer of the Association appointed by the Board of Governors who shall be charged with responsibility for the administrative details and actual management of the affairs of the Association and shall be responsible to the Board of Governors therefor. The Executive Director shall be a member of and attend all Board and Executive meetings, except when advised by other members of the Board of Governors that his presence is not required.

The Executive Director shall be responsible for the recording and retaining of the minutes of all such meetings and shall be responsible for their proper distribution.

The Executive Director shall, in addition, carry out the normal duties of a corporation secretary, and shall conduct all general correspondence on behalf of the Association but he shall not be empowered to make financial commitments on behalf of the Association, other than matters of day-to-day administration, unless such commitments have been included in a budget previously approved by the Board of Governors, nor on any matters affecting the broad policy of the Association without the express authorization of the Board of Governors. The Executive Director shall make a complete report at least monthly to the Board of Governors on general activities of the Association. The terms of employment of the Executive Director shall be regulated from time to time by order of the Board of Governors, but in any event he shall furnish a fidelity bond in an amount satisfactory to the Board. In addition, the Executive Director shall be charged with the care of all financial matters of the Association as well as maintaining and retaining all records of the Association as directed by the Honorary Treasurer.

Article VIII. COMMITTEES

1. Executive Committee. There shall be an Executive Committee of the Board of Governors which shall act in an advisory capacity on matters of policy for the Executive Director in the day-to-day administration of affairs of the Association and serve as an Executive of the Board of Governors in making administrative and policy decisions of a minor nature between meetings of the Board of Governors, provided that all such policy decisions shall be reported in full to the next meeting of the Board of Governors and shall be subject to ratification thereat. The Executive Committee shall, in any event, report all its activities at each meeting of the Board of Governors.

The Executive Committee shall consist of the Immediate Past President, the President, the Vice President, the Honorary Treasurer and the Executive Director. A quorum for the conduct of the business of the Executive Committee shall be a majority of the members from time to time comprising the Executive Committee.

2. Nominating Committee. The President, at the time of the Semi-Annual Meeting of the Board, will appoint a Nominating Committee of three past presidents of the Association who are, at the time, active in the retail hardware business. The Nominating Committee shall be responsible for preparing a slate of candidates for all electoral districts and sub-districts and ensuring that there is at least one nominee for each district or sub-district. This slate will be circulated to all Active Members and Honorary Life Members together with a request for further nominations at least 90 days prior to the date of the Annual General Meeting.

3. Special Committees. The President may appoint Special Committees to examine and report to the Board on specific matters affecting the affairs of the Association, but such Special Committees shall have investigative powers only and each of such committees shall be constituted for the term of office of the President, unless their appointment is terminated by the President at an earlier date. All Special Committees shall report all their activities at each meeting of the Board of Governors.

Article IX. REGIONAL ASSOCIATIONS

1. Affiliation. The Canadian Retail Hardware Association shall accept the affiliation with it of any active Regional Hardware Associations whose application for affiliation with the Canadian Retail Hardware Association, upon approved form, is approved by the Board of Governors or by the Executive Committee on behalf of the Board.

2. Term of Affiliation. Affiliation under Article IX (1) above will be granted to a Regional Hardware Association for a term of one year only.

3. Renewal of Affiliation. The Canadian Retail Hardware Association shall renew such affiliation for a further term of one year, upon application of a Regional Hardware Association provided that such application for renewal is approved by the Board or by the Executive Committee on behalf of the Board.

4. Financial Support. The Canadian Retail Hardware Association shall pay to the Treasurer of any Regional Hardware Association to which affiliation has been granted as herein set out, a sum of money authorized by the Board of Governors and based upon the number of members of the Regional Association which are also members of the Canadian Retail Hardware Association in good standing, providing that the amount so paid per member does not exceed the amount paid directly by a member for membership in the Regional Association and provided also that proof of direct membership payment is submitted to the Canadian Retail Hardware Association in a form suitable to the Board of Governors thereof.

Article X. CONSTITUTIONAL AMENDMENT

1. This Constitution of the Canadian Retail Hardware Association may be amended in the following manner:

(a) The Board of Governors may prepare a draft of any proposed amendment and submit the same by referendum (in manner herein provided with respect to the submitting of a referendum to the members) to all active members and Honorary Life Members for approval, and in the event of approval of such proposed amendment by a two-thirds majority of such members, or of those who shall have expressed approval or disapproval, (regard being had only to those who shall have responded with respect to such referendum as herein provided) such amendment shall be deemed to have been made accordingly.

(b) Any fifty active members or Honorary Life Members may petition the Board of Governors in writing requesting any amendment to the Constitution setting forth the terms of the proposed amendment, and in such case the Board of Governors shall submit the same to all active members and Honorary Life Members by referendum in manner aforesaid, and in the event of approval by a two-thirds majority as aforesaid such amendment shall be deemed to have been made accordingly.

For the purpose of the foregoing provisions with respect to amendment of the Constitution, all members desiring to express approval or disapproval of any proposed amendment shall communicate such approval or disapproval to the said Board in writing within fifteen days after the date of the mailing of such referendum to members.

Article XI. MEMBERSHIP FEES

1. The Membership Fees shall be those set from time to time by the Board of Governors.

2. Members in Arrears. The Executive Director shall report to the Board of Governors the names of all members in arrears for dues. The Board of Governors shall have power to suspend membership or take other action which they deem appropriate in the circumstances.

Canadian Retail Hardware Association,
290 Merton Street,
Toronto 7, Ontario.

1968 FINANCIAL SURVEY

A REPORT OF RETAIL HARDWARE STORES OPERATIONS FOR 1968

ENQUÊTE FINANCIÈRE 1968

RAPPORT DES OPERATIONS DES QUINCAILLIERS DETAILLANTS EN 1968

1968 — CONTENTS — 1968

— FOREWORD —

This Survey has been produced through the co-operation of 190 reporting retailers. This group of retailers deserve the thanks of all those members who will receive the benefits of this project.

This year's Survey contains many new features which we are sure will prove interesting and useful to all hardware retail managers.

There has been a slight change in the "Profit Maker Survey"; Net Profit earned compared to total investment was used as the guide to the "Profit Makers". These owners all earned better than 25% on their capital investment in the business. Other new features are the Department Sales per square foot figures and the comparison of "Similar Stores".

The most important new feature is scheduled on the last two pages of the Survey. These important ratios will give the reader a greater insight into money management in a retail business.

1968 — TABLE DES MATIERES — 1968

— AVANT-PROPOS —

Cette Etude a été préparée grâce à la collaboration de 190 détaillants participants. Ce groupe de détaillants mérite la gratitude de tous les membres qui profiteront de ce projet.

Cette année, l'Enquête offre plusieurs innovations qui s'avèreront utiles et intéressantes pour tous les gérants de quincaillerie au détail.

Un changement a été effectué dans "l'Enquête des Magasins Rentables". Le Profit Net réalisé se trouve comparé à l'investissement total pour les magasins rentables. Ces propriétaires ont tous réalisé plus de 25% sur leur capital investi dans l'entreprise. Vous noterez aussi les chiffres des ventes par pied carré, par rayon, ainsi qu'une comparaison des "Magasins Semblables".

La nouveauté la plus importante se trouve sur les deux dernières pages de l'Enquête. Ces proportions importantes donneront au lecteur une connaissance plus approfondie de la gestion financières d'un commerce au détail.

1968 AVERAGES OF 190 REPORTING STORES
MOYENNES DE 190 MAGASINS DANS LE RAPPORT EN 1968

1968 CANADA	Atlantic Provinces / Provinces de l'Atlantique	%	Québec	%	Ontario	%	Prairie Provinces / Provinces des Prairies	%	B.C. / C.B.	%	Average of 190 Reporting Stores / Moyennes de Magasins dans le rapport	%
Number of Stores • Nombre de Magasins	13		39		80		32		26		190	
Total Sales / Total des ventes:	$285,716	100.0	$184,168	100.0	$129,565	100.0	$178,234	100.0	$176,510	100.0	$166,078	100.0
Cost of Goods Sold / Coût des marchandises vendues	213,084	74.6	134,211	72.9	90,873	70.1	129,128	72.4	119,655	67.8	118,512	71.4
Gross Profit on Sales / Profit brut sur les ventes	72,632	25.4	49,957	27.1	38,692	29.9	49,106	27.6	56,855	32.2	47,566	28.6
Expenses / Dépenses:												
Employee Wages / Salaires des employés	29,192	10.2	17,664	9.6	12,561	9.7	16,952	9.5	18,941	10.7	16,359	9.9
Proprietor's Drawings or Manager's Salary / Prélèvements du propriétaire ou salaire du gérant	10,132	3.5	8,482	4.6	8,378	6.5	7,907	4.4	10,064	5.7	8,671	5.2
Costs of Occupancy or Rent / Frais d'occupation ou de location	5,657	2.0	4,750	2.6	3,400	2.6	4,969	2.8	4,711	2.7	4,275	2.6
Advertising / Publicité	2,504	0.9	1,926	1.0	1,457	1.1	2,927	1.6	2,412	1.4	2,003	1.2
Delivery Costs / Frais de livraison	2,133	0.8	1,520	0.8	1,102	0.9	1,397	0.8	1,250	0.7	1,329	0.8
Depreciation – Store Fixtures / Amortissement – ameublement de magasin	1,256	0.4	595	0.3	644	0.5	639	0.4	644	0.4	675	0.4
Depreciation – Delivery Equipment / Amortissement – équipement de livraison	1,712	0.6	872	0.5	524	0.4	447	0.3	569	0.3	670	0.4
Heat, Light, Power / Chauffage, éclairage, électricité	1,273	0.4	1,024	0.6	776	0.6	1,087	0.6	976	[illegible]	940	0.6
Lic. & Bus. Taxes * / Licences et taxes d'aff. *	1,045	0.4	452	0.2	557	0.4	457	0.3	219	0.1	506	0.3
Insurance (not on building) / Assurance (non sur l'édifice)	971	0.3	1,213	0.7	545	0.4	512	0.3	716	0.4	729	0.4
Interest Paid on Borrowed Capital / Intérêt payé sur capital emprunté	1,678	0.6	940	0.5	667	0.5	795	0.4	1,149	0.6	880	0.5
Repairs and Maintenance / Réparations et entretien	666	0.2	703	0.4	349	0.3	667	0.4	746	0.4	551	0.3
Telephone / Téléphone	1,002	0.4	557	0.3	358	0.3	569	0.3	571	0.3	508	0.3
Bad Debts Written Off / Dettes non récupérables	1,056	0.4	620	0.3	575	0.4	636	0.4	1,186	0.7	711	0.4
Accounting and Auditing / Comptabilité et vérification	2,376	0.8	1,166	0.6	390	0.3	740	0.4	430	0.2	750	0.5
Miscellaneous / Divers	2,932	1.0	2,463	1.4	1,573	1.2	2,500	1.4	5,186	2.9	2,499	1.5
Total Expenses / Total des dépenses	65,585	22.9	44,947	24.4	33,856	26.2	43,201	24.3	49,770	28.2	42,055	25.3
Net Profit / Profit net	7,046	2.5	5,010	2.7	4,836	3.7	5,905	3.3	7,085	4.0	5,511	3.3
Other Income / Autres revenus	3,173	1.1	1,037	0.6	1,108	0.8	2,535	1.4	2,299	1.3	1,638	1.0
Net Income Before Income Taxes / Total des gains des propriétaires par rapport aux ventes	10,219	3.6	6,047	3.3	5,944	4.5	8,440	4.7	9,384	5.3	7,149	4.3
Proprietor's Total Return Compared to Sales / Total des gains des propriétaires par rapport aux ventes	20,351	7.1	14,529	7.9	14,322	11.0	16,347	9.1	19,448	11.0	15,820	9.5
Inventory to Cost of Sales (turnover) / Stocks au coût des ventes (chiffre d'affaires)	74,809	2.8 Times	51,035	2.6 Times	40,337	2.3 Times	57,356	2.4 Times	55,974	2.1 Times	49,852	2.4 Times

* not realty or income taxes * non l'imp. foncier ou sur le rev

39 STORES IN QUEBEC BY POPULATION CENTRES
39 MAGASINS EN QUEBEC PAR CENTRES DE POPULATION

1968 AVERAGES QUEBEC MOYENNES 1968	POPULATION					
	Below 5,000 12 Stores Moins de 5,000 12 Magasins		5,000-20,000 20 Stores 20 Magasins		Over 20,000 7 Stores Plus de 20,000 7 Magasins	
	$	%	$	%	$	%
Total Sales: Total des ventes:	$133,456	[illegible]	$200,275	[illegible]	$225,079	[illegible]
Cost of Goods Sold Coût des marchandises vendues	96,851	[illegible]	143,528	[illegible]	171,634	[illegible]
Gross Profit on Sales Profit brut sur les ventes	36,605	[illegible]	56,747	[illegible]	53,445	[illegible]
Expenses: Depenses:						
Employee Wages Salaires des employés	10,256	[illegible]	21,056	[illegible]	20.675	[illegible]
Proprietor's Drawings or Manager's Salary Prélèvements du propriétaire ou salaire du gérant	8,017	[illegible]	8,588	[illegible]	8,975	[illegible]
Costs of Occupancy or Rent Frais d'occupation ou de location	3,019	[illegible]	6,043	[illegible]	4,021	[illegible]
Avertising Publicité	1,021	[illegible]	2,323	[illegible]	2,343	[illegible]
Delivery Costs Frais de livraison	1,024	[illegible]	1,735	[illegible]	1,758	[illegible]
Depreciation—Store Fixtures Amortissement—ameublement de magasin	596	[illegible]	660	[illegible]	428	[illegible]
Depreciation—Delivery Equipment Amortissement—équipement de livraison	662	[illegible]	930	[illegible]	1,067	[illegible]
Heat, Light, Power Chauffage, éclairage, électricité	686	[illegible]	1,122	[illegible]	978	[illegible]
Lic. & Bus. Taxes * Licences et taxes d'aff. *	145	[illegible]	582	[illegible]	607	[illegible]
Insurance (not on building) Assurance (non sur l'édifice)	1,039	[illegible]	1,320	[illegible]	1,209	[illegible]
Interest Paid on Borrowed Capital Intérêt payé sur capital emprunté	414	[illegible]	1,376	[illegible]	597	[illegible]
Repairs and Maintenance Réparations et entretien	827	[illegible]	731	[illegible]	411	[illegible]
Telephone Téléphone	428	[illegible]	617	[illegible]	606	[illegible]
Bad Debts Written Off Dettes non récupérables	1,027	[illegible]	498	[illegible]	272	[illegible]
Accounting and Auditing Comptabilité et vérification	355	[illegible]	1,286	[illegible]	2,214	[illegible]
Miscellaneous Divers	1,478	[illegible]	3,113	[illegible]	2,286	[illegible]
Total Expenses: Total des dépenses	31,184	[illegible]	51,980	[illegible]	48,447	[illegible]
Net Profit: Profit net	5,421	[illegible]	4,767	[illegible]	4,998	[illegible]
Other Income Autres revenus	145	[illegible]	1,737	[illegible]	562	[illegible]
Net Income Before Income Taxes Total des gains des propriétaires par rapport aux ventes	5,566	[illegible]	6,504	[illegible]	5.560	[illegible]
Proprietor's Total Return Compared to Sales Total des gains des proprétaires par rapport aux ventes	13,683	[illegible]	15,092	[illegible]	14,535	[illegible]
Inventory to Cost of Sales (turnover) Stocks au coût des ventes (chiffre d'affaires)	41,565	[illegible]	53,501	[illegible]	60,226	[illegible]

* not realty or income taxes * non l'imp. foncier ou sur le rev

39 STORES IN QUEBEC BY SALES VOLUME
39 MAGASINS EN QUEBEC PAR VOLUME DE VENTES

1968 AVERAGES QUEBEC MOYENNES 1968	SALES – VENTES							
	Below $75,000 Sales 6 Stores / Ventes de moins de $75,000 6 magasins		$75,000-$100,000 Sales 5 Stores / Ventes de $75,000-$100,000 5 magasins		$100,000-$150,000 Sales 12 Stores / Ventes de $100,000-$150,000 12 magasins		Over $150,000 Sales 16 Stores / Ventes de $150,000 et plus 16 magasins	
	$	%	$	%	$	%	$	%
Total Sales / Total des ventes:	$55,356	100.0	$89,158	100.0	$125,294	100.0	$306,318	100.0
Cost of Goods Sold / Coût des marchandises vendues	39,587	[illegible]	58,785	65.9	89,462	71.4	226,826	[illegible]
Gross Profit on Sales / Profit brut sur les ventes	15,769	[illegible]	30,373	34.1	35,832	28.6	79,492	[illegible]
Expenses / Dépenses								
Employee Wages / Salaires des employés	3,543	[illegible]	7,713	[illegible]	10,771	[illegible]	31,239	[illegible]
Proprietor's Drawings or Manager's Salary / Prelèvements du propriétaire ou salaire du gérant	4,682	[illegible]	7,845	[illegible]	8,388	[illegible]	10,175	[illegible]
Costs of Occupancy or Rent / Frais d'occupation ou de location	2,349	[illegible]	2,588	[illegible]	3,645	[illegible]	7,154	[illegible]
Avertising / Publicité	598	[illegible]	616	[illegible]	1,097	[illegible]	3,456	[illegible]
Delivery Costs / Frais de livraison	604	[illegible]	891	[illegible]	1,529	[illegible]	2,054	[illegible]
Depreciation – Store Fixtures / Amortissement – ameublement de magasin	345	[illegible]	404	[illegible]	273	[illegible]	991	[illegible]
Depreciation – Delivery Equipment / Amortissement – équipement de livraison	329	[illegible]	540	[illegible]	672	[illegible]	1,329	[illegible]
Heat Light Power / Chauffage, éclairage, électricité	405	[illegible]	525	[illegible]	878	0.7	1,522	[illegible]
Lic. & Bus. Taxes * / Licences et taxes d'aff. *	175	[illegible]	338	0.4	248	[illegible]	744	[illegible]
Insurance (not on building) / Assurance (non sur l'édifice)	446	[illegible]	1,076	1.2	559	[illegible]	2,035	[illegible]
Interest Paid on Borrowed Capital / Interêt payé sur capital emprunté	290	[illegible]	620	[illegible]	607	[illegible]	1,534	[illegible]
Repairs and Maintenance / Réparations et entretien	133	[illegible]	449	[illegible]	657	[illegible]	1,034	[illegible]
Telephone / Téléphone	326	[illegible]	305	[illegible]	454	[illegible]	799	[illegible]
Bad Debts Written Off / Dettes non récupérables	206	[illegible]	1,479	[illegible]	462	[illegible]	625	[illegible]
Accounting and Auditing / Comptabilité et vérification	2,161	[illegible]	397	[illegible]	312	[illegible]	1,676	[illegible]
Miscellaneous / Divers	566	[illegible]	528	[illegible]	2,000	[illegible]	4,120	[illegible]
Total Expenses / Total des dépenses	17,158	[illegible]	26,314	[illegible]	32,552	[illegible]	70,487	[illegible]
Net Profit / Profit net	(1,389)	[illegible]	4,059	[illegible]	3,280	[illegible]	9,005	[illegible]
Other Income / Autres revenus	251	[illegible]	449	[illegible]	178	[illegible]	2,158	[illegible]
Net Income Before Income Taxes / Total des gains des propriétaires par rapport aux ventes	(1,138)	[illegible]	4,508	[illegible]	3,458	[illegible]	11,163	[illegible]
Proprietor's Total Return Compared to Sales / Total des gains des propretaires par rapport aux ventes	3,544	[illegible]	12,253	[illegible]	11,846	[illegible]	21,338	[illegible]
Inventory to Cost of Sales (turnover) / Stocks au coût des ventes (chiffre d'affaires)	22,666	[illegible] Fois	32,505	1.8 Fois	35,389	[illegible] Fois	79,199	[illegible] Times

* not realty or income taxes * non l'imp. foncier ou sur le rev

80 ONTARIO STORES BY POPULATION CENTRES
80 MAGASINS EN ONTARIO PAR CENTRES DE POPULATION

1968 AVERAGES ONTARIO MOYENNES 1968	POPULATION				
	Below 5,000 37 Stores / Moins de 5,000 37 Magasins	5,000-20,000 17 Stores / 5,000-20,000 17 Magasins	20,000-100,000 7 Stores / 20,000-100,000 7 Magasins	100,000-1,000,000 9 Stores / 100,000-1,000,000 9 Magasins	Over 1,000,000 Metro Toronto 10 Stores / Plus de 1,000,000 Metro Toronto 10 Magasins
	$	$	$	$	$
Total Sales: Total des ventes:	$120,677	$160,066	$193,332	$87,881	$103,480
Cost of Goods Sold Coût des marchandises vendues	86,300	112,983	130,866	57,354	72,381
Gross Profit on Sales Profit brut sur les ventes	34,377	47,083	62,466	30,527	31,099
Expenses: Dépenses:					
Employee Wages Salaires des employés	10,7[illegible]	15,91[illegible]	22,650	10,360	8,307
Proprietor's Drawings or Manager's Salary Prélèvements du propriétaire ou salaire du gérant	7,371	9,52[illegible]	11,098	9,667	7,628
Costs of Occupancy or Rent Frais d'occupation ou de location	2,611	3,4[illegible]	6,523	3,075	4,283
Avertising Publicité	1,256	2,07[illegible]	2,615	950	792
Delivery Costs Frais de livraison	1,2[illegible]	74[illegible]	1,574	724	978
Depreciation—Store Fixtures Amortissement—ameublement de magasin	594	971	710	324	665
Depreciation—Delivery Equipment Amortissement—équipement de livraison	[illegible]	[illegible]	344	623	483
Heat, Light, Power Chauffage, éclairage, électricité	[illegible]	1,0[illegible]	1,01[illegible]	494	636
Lic. & Bus. Taxes * Licences et taxes d'aff. *	2[illegible]3	1,03[illegible]	[illegible]	263	410
Insurance (not on building) Assurance (non sur l'édifice)	47[illegible]	74[illegible]	[illegible]	439	375
Interest Paid on Borrowed Capital Intérêt payé sur capital emprunté	671	[illegible]	1,312	566	271
Repairs and Maintenance Réparations et entretien	414	2[illegible]	[illegible]	150	399
Telephone Téléphone	335	146	5[illegible]	247	397
Bad Debts Written Off Dettes non récupérables	485	1,10[illegible]	670	208	276
Accounting and Auditing Comptabilité et vérification	353	171	36[illegible]	356	433
Miscellaneous Divers	1,018	3,21[illegible]	1,657	1,066	1,230
Total Expenses: Total des dépenses	29,251	41,899	54,011	28,903	27,56[illegible]
Net Profit: Profit net	5,126	5,1[illegible]	8,45[illegible]	1,624	3,5[illegible]
Other Income Autres revenus	1,197	1,191	2,115	720	263
Net Income Before Income Taxes Total des gains des propriétaires par rapport aux ventes	6,323	6,37[illegible]	10,570	2,344	3,813
Proprietor's Total Return Compared to Sales Total des gains des propriétaires par rapport aux ventes	13,694	15,9[illegible]	21,66[illegible]	11,410	11,44[illegible]
Inventory to Cost of Sales (turnover) Stocks au coût des ventes (chiffre d'affaires)	38.392	48.2[illegible]8	63.661	22.727	33.4[illegible]

* not realty or income taxes * non l'imp. foncier ou sur le rev

80 ONTARIO STORES BY SALES VOLUME
80 MAGASINS EN ONTARIO PAR VOLUME DE VENTES

1968 AVERAGES ONTARIO MOYENNES 1968	SALES – VENTES									
	Below $50,000 Sales 11 Stores / Ventes de Moins de $50,000 11 Magasins		$50,000 - $75,000 Sales 12 Stores / Ventes de $50,000 - $75,000 12 Magasins		$75,000 - $100,000 Sales 14 Stores / Ventes de $75,000 - $100,000 14 Magasins		$100,000-$150,000 Sales 22 Stores / Ventes de $100,000-$150,000 22 Magasins		Over $150,000 Sales 21 Stores / Ventes de $150,000 et plus 21 Magasins	
	$	[illegible]	$	[illegible]	$	[illegible]	$	[illegible]	$	[illegible]
Total Sales / [illegible]tal des ventes	$38,942	[illegible]	$64,053	[illegible]	$84,734	[illegible]	$120,556	[illegible]	$253,795	[illegible]
[illegible]st of Goods Sold / Coût des marchandises vendues	26,571	[illegible]	45,496	[illegible]	58,180	[illegible]	82,845	[illegible]	180,693	[illegible]
[illegible] Profit on Sales / [illegible]	12,371	[illegible]	18,557	[illegible]	26,554	[illegible]	37,711	[illegible]	73,102	[illegible]
[illegible]		[illegible]		[illegible]		[illegible]		[illegible]		[illegible]
[illegible]	1,748	[illegible]	3,930	[illegible]	6,347	[illegible]	11,318	[illegible]	28,603	[illegible]
[illegible] Drawings or Manager's Salary / [illegible] du propriétaire ou salaire du gérant	6,052	[illegible]	5,969	[illegible]	7,169	[illegible]	9,346	[illegible]	10,765	[illegible]
Costs of Occupancy or Rent / Frais d'occupation ou de location	1,713	[illegible]	2,104	[illegible]	2,494	[illegible]	3,635	[illegible]	5,383	[illegible]
Avertising / [illegible]	281	[illegible]	827	[illegible]	1,214	[illegible]	1,205	[illegible]	2,860	[illegible]
Delivery Costs / Frais de livraison	531	[illegible]	861	[illegible]	793	[illegible]	1,059	[illegible]	1,795	[illegible]
Depreciation – Store Fixtures / [illegible] – ameublement de magasin	638	[illegible]	410	[illegible]	497	[illegible]	642	[illegible]	882	[illegible]
[illegible] - Delivery Equipment / [illegible] – équipement de livraison	510	[illegible]	518	[illegible]	444	[illegible]	438	[illegible]	676	[illegible]
[illegible] Power / [illegible]uffage, eclairage, électricité	380	[illegible]	494	[illegible]	709	[illegible]	776	[illegible]	1,190	[illegible]
Lic. & Bus. Taxes * / Licences et taxes d'aff. *	253	[illegible]	238	[illegible]	261	[illegible]	570	[illegible]	1,082	[illegible]
Insurance (not on building) / [illegible]	229	[illegible]	277	[illegible]	472	[illegible]	376	[illegible]	1,089	[illegible]
[illegible] Borrowed Capital / Intérêt payé sur capital emprunté	84	[illegible]	340	[illegible]	674	[illegible]	472	[illegible]	1,359	[illegible]
[illegible]airs and Maintenance / [illegible] ons et entretien	292	[illegible]	226	[illegible]	460	[illegible]	466	[illegible]	253	[illegible]
[illegible]	253	[illegible]	349	[illegible]	298	[illegible]	315	[illegible]	502	[illegible]
[illegible]	126	[illegible]	191	[illegible]	235	[illegible]	365	[illegible]	1,475	[illegible]
[illegible]	119	[illegible]	248	[illegible]	419	[illegible]	307	[illegible]	680	[illegible]
[illegible]	364	[illegible]	442	[illegible]	730	[illegible]	1,404	[illegible]	3,589	[illegible]
[illegible]	13,573	[illegible]	17,424	[illegible]	23,216	[illegible]	32,694	[illegible]	62,183	[illegible]
Net Profit / Profit net	(1,202)	[illegible]	1,133	[illegible]	3,338	[illegible]	5,017	[illegible]	10,919	[illegible]
[illegible]her Income / [illegible]	1,032	[illegible]	257	[illegible]	1,042	[illegible]	1,140	[illegible]	1,646	[illegible]
[illegible]ome Before Income Taxes / Total des gains des propriétaires par rapport aux ventes	(170)	[illegible]	1,390	[illegible]	4,380	[illegible]	6,157	[illegible]	12,565	[illegible]
[illegible]oprietor's Total Return Compared to Sales / [illegible]tal des gains des propriétaires par rapport aux ventes	5,882	[illegible]	7,359	[illegible]	11,549	[illegible]	15,503	[illegible]	23,330	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]nventory to Cost of Sales (turnover) / Stocks au coût des ventes (chiffre d'affaires)	14,693	[illegible] Times	21,361	[illegible]	28,444	[illegible] Times	39,522	[illegible]	73,398	[illegible]

[illegible]not realty or income taxes * non l'imp. foncier ou sur le rev

26 BRITISH COLUMBIA STORES BY POPULATION CENTRES
26 MAGASINS EN C.B. PAR CENTRES DE POPULATION

1968 AVERAGES BRITISH COLUMBIA MOYENNES 1968	POPULATION			
	Below 5,000 8 Stores Moins de 5,000 8 Magasins	5,000 - 20,000 7 Stores 7 Magasins	20,000 - 100,000 3 Stores 3 Magasins	Over 100,000 8 Stores Plus de 100,000 8 Magasins
	$	$	$	$
Total Sales: Total des ventes:	$212,265	$261,475	$181,517	$63,879
Cost of Goods Sold Coût des marchandises vendues	152,614	170.173	121,753	41,955
Gross Profit on Sales Profit brut sur les ventes	59,651	91,302	59,764	21,924
Expenses: Dépenses:				
Employee Wages Salaires des employés	16,842	[illegible]	[illegible]	4,754
Proprietor's Drawings or Manager's Salary Prélèvements du propriétaire ou salaire du gérant	13,031	[illegible]	9,733	6,724
Costs of Occupancy or Rent Frais d'occupation ou de location	[illegible]	[illegible]	[illegible]	2,550
Avertising Publicité	2.630	4,013	1,629	674
Delivery Costs Frais de livraison	1,237	2,169	565	647
Depreciation – Store Fixtures Amortissement – ameublement de magasin	786	955	495	226
Depreciation – Delivery Equipment Amortissement – équipement de livraison	666	902	329	282
Heat, Light, Power Chauffage, éclairage, électricité	1,363	1,121	1,713	471
Lic. & Bus. Taxes * Licences et taxes d'aff. *	106	401	139	128
Insurance (not on building) Assurance (non sur l'édifice)	835	1,152	525	301
Interest Paid on Borrowed Capital Intérêt payé sur capital emprunté	1,388	1,359	1,227	167
Repairs and Maintenance Réparations et entretien	433	1,878	524	186
Telephone Téléphone	698	[illegible]	838	274
Bad Debts Written Off Dettes non récupérables	2,695	1,002	815	27
Accounting and Auditing Comptabilité et vérification	305	645	205	220
Miscellaneous Divers	2,745	15,769	5,913	655
Total Expenses: Total des dépenses	53,450	81,374	50,013	18,285
Net Profit: Profit net	6,201	9,928	9,751	3,639
Other Income Autres revenus	3,783	3,825	3,677	363
Net Income Before Income Taxes Total des gains des propriétaires par rapport aux ventes	9,984	13,753	13,428	3,684
Proprietor's Total Return Compared to Sales Total des gains des proprétaires par rapport aux ventes	23,014	24,[illegible]	23,161	10,408
Inventory to Cost of Sales (turnover) Stocks au coût des ventes (chiffre d'affaires)	69,174	76,617	67,286	[illegible]

* not realty or income taxes * non l'imp. foncier ou sur le rev

26 BRITISH COLUMBIA STORES BY SALES VOLUME
26 MAGASINS EN C.B. PAR VOLUME DE VENTES

1968 — AVERAGES BRITISH COLUMBIA MOYENNES 1968	SALES — VENTES Below $75,000 7 Stores Moins de $75,000 7 Magasins		$75,000 - $150,000 7 Stores 7 Magasins		Over $150,000 12 Stores Plus de $150,000 12 Magasins	
	$	%	$	%	$	%
Total Sales Total des ventes	$42,905	[illegible]	$106,350	100.0	$295,374	[illegible]
Cost of Goods Sold Coût des marchandises vendues	29,715	[illegible]	69,091	[illegible]	201,617	68.3
Gross Profit on Sales Profit brut sur les ventes	13,190	[illegible]	37,259	[illegible]	93,757	31.7
Expenses Dépenses						
Employee Wages Salaires des employes	1,830	[illegible]	9,909	[illegible]	34,192	[illegible]
Proprietor's Drawings or Manager's Salary Prelevements du propriétaire ou salaire du gérant	5,111	[illegible]	9,290	[illegible]	13,406	[illegible]
Costs of Occupancy or Rent Frais d'occupation ou de location	1,956	[illegible]	3,619	[illegible]	6,955	[illegible]
Avertising Publicité	796	[illegible]	1,658	[illegible]	3,795	[illegible]
Delivery Costs Frais de livraison	244	[illegible]	694	[illegible]	2,162	0.7
Depreciation — Store Fixtures Amortissement — ameublement de magasin	411	[illegible]	632	[illegible]	786	0.3
Depreciation — Delivery Equipment Amortissement — équipement de livraison	144	[illegible]	337	[illegible]	953	0.3
Heat, Light, Power Chauffage, eclairage, électricité	409	[illegible]	757	0.7	1,434	0.5
Lic. & Bus Taxes * Licences et taxes d'aff. *	139	[illegible]	130	[illegible]	318	0.1
Insurance (not on building) Assurance (non sur l'édifice)	220	[illegible]	419	[illegible]	1,178	[illegible]
Interest Paid on Borrowed Capital Interêt payé sur capital emprunté	488	[illegible]	487	[illegible]	1,922	[illegible]
Repairs and Maintenance Réparations et entretien	163	[illegible]	279	[illegible]	1,358	[illegible]
Telephone Telephone	175	[illegible]	471	[illegible]	860	[illegible]
Bad Debts Written Off Dettes irrécouvrables	91	[illegible]	217	[illegible]	2,390	[illegible]
Accounting and Auditing Comptabilité et vérification	168	[illegible]	407	[illegible]	596	[illegible]
Miscellaneous Divers	261	[illegible]	987	[illegible]	10,503	[illegible]
Total Expenses Total des dépenses	12 606	[illegible]	30,293	[illegible]	82,808	[illegible]
Net Profit Profit net	584	[illegible]	6,966	[illegible]	10.949	3.7
Other Income Autres revenus	333	[illegible]	414	[illegible]	4,545	1.5
Income Before Income Taxes Total des gains des proprietaires par rapport aux ventes	917	[illegible]	7,380	[illegible]	15,494	5.2
Proprietor's Total Return Compared to Sales Total des gains des propretaires par rapport aux ventes	6.028	[illegible]	16,670	[illegible]	28.900	[illegible]
Inventory to Cost of Sales (turnover) Stocks au coût des ventes (chiffre d'affaires)	28,894	[illegible]	44,896	[illegible] Times	89,346	[illegible] Times

* not realty or income taxes * non l'imp. foncier ou sur le rev

32 Stores in the Prairie Provinces by Sales Volume and Population Centres
32 Magasins dans les Provinces des Prairies par Volume de Ventes par Centres de Population

1968 AVERAGES PRAIRIE PROVINCES MOYENNES 1968	SALES – VENTES				POPULATION	
	Below $50,000 7 Stores Moins de $50,000 7 Magasins	$50,000 - $75,000 4 Stores 4 Magasins	$75,000 - $150,000 8 Stores 8 Magasins	Over $150,000 13 Stores Plus de $150,000 13 Magasins	Below 5,000 25 Stores Moins de 5,000 25 Magasins	Over 5,000 7 Stores Plus de 5,000 7 Magasins
	$	$	$	$	$	$
Total Sales: Total des ventes:	$28,282	$58,746	$115,47[illegible]	$354,36[illegible]	$110,1[illegible]	$421,[illegible]
Cost of Goods Sold Coût des marchandises vendues	20,503	45,374	83,989	241,1[illegible]	79,737	30[illegible],347
Gross Profit on Sales Profit brut sur les ventes	7,[illegible]	[illegible]	31,4[illegible]	93,197	30,321	116,1[illegible]
Expenses: Dépenses:						
Employee Wages Salaires des employés	1,5[illegible]	3,900	10,434	33,270	10,646	39,471
Proprietor's Drawings or Manager's Salary Prélèvements du propriétaire ou salaire du gérant	4,45[illegible]	[illegible]	5,91[illegible]	12,907	6,613	12,52[illegible]
Costs of Occupancy or Rent Frais d'occupation ou de location	1,172	1,[illegible]	[illegible]	6,983	2,682	13,139
Avertising Publicité	22[illegible]	[illegible]	[illegible]	[illegible],074	1,099	5,45[illegible]
Delivery Costs Frais de livraison	201	[illegible]	[illegible]	2,867	863	3,302
Depreciation – Store Fixtures Amortissement – ameublement de magasin	223	[illegible]	[illegible]	1,063	498	1,149
Depreciation – Delivery Equipment Amortissement – équipement de livraison	94	41	[illegible]	844	347	607
Heat, Light, Power Chauffage, éclairage, électricité	[illegible]	34	[illegible]	1,7[illegible]	805	2,103
Lic. & Bus. Taxes * Licences et taxes d'aff. *	161	[illegible]	[illegible]	747	298	1,024
Insurance (not on building) Assurance (non sur l'édifice)	13[illegible]	311	29[illegible]	90[illegible]	478	631
Interest Paid on Borrowed Capital Intérêt payé sur capital emprunté	[illegible]	[illegible]17	[illegible]	1,416	552	1,661
Repairs and Maintenance Réparations et entretien	17[illegible]	105	748	1,054	346	1,812
Telephone Téléphone	18[illegible]	253	272	1,054	367	1,291
Bad Debts Written Off Dettes non récupérables	[illegible]	119	[illegible]	944	672	50[illegible]
Accounting and Auditing Comptabilité et vérification	99	47	38[illegible]	1,521	302	2,307
Miscellaneous Divers	28[illegible]	152	30[illegible]	5,459	1,042	9,141
Total Expenses: Total des dépenses	9,31[illegible]	12,651	28,[illegible]	79,846	27,606	98,83[illegible]
Net Profit: Profit net	(2,03[illegible]	[illegible]	3,31[illegible]	13,3[illegible]	2,713	17,3[illegible]
Other Income Autres revenus	62[illegible]	572	[illegible]	5,46[illegible]	1,731	5,4[illegible]
Net Income Before Income Taxes Total des gains des propriétaires par rapport aux ventes	(1,407[illegible]	1,2[illegible]3	3,7[illegible]	18,813	4,444	22,[illegible]
Proprietor's Total Return Compared to Sales Total des gains des propriétaires par rapport aux ventes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Inventory to Cost of Sales (turnover) Stocks au coût des ventes (chiffre d'affaires)	[illegible]	26,123	[illegible]	101,004	38,451	124,969

* not realty or income taxes * non l'imp. foncier ou sur le rev

1968 SALES BREAKDOWN BY GEOGRAPHICAL AREAS
REPARTITION DES VENTES PAR ZONES GEOGRAPHIQUES EN 1968

BY MONTH PAR MOIS	Atlantic Provinces Provinces De L'Atlantique	Quebec	Ontario	Prairie Provinces Province Des Prairies	B.C. C.B.	All Store Provinces Moyennes De Tous Magasins	Your Store Votre Magasin
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
	%	%	%	%	%	[illegible]	%
[illegible]	5.1	5.2	5.5	5.9	5.2	[illegible]	
[illegible]	4.1	4.7	4.8	5.1	5.4	[illegible]	
[illegible]	5.4	5.8	6.0	6.1	7.1	[illegible]	
[illegible]	5.9	7.9	7.4	8.0	7.5	[illegible]	
[illegible]	8.7	11.0	9.6	8.9	10.0	[illegible]	
[illegible]	8.8	10.4	10.1	9.1	9.3	[illegible]	
July Julliet	9.1	9.7	9.9	8.2	9.1	[illegible]	
August Août	8.9	8.9	9.3	8.8	8.7	[illegible]	
September Septembre	8.9	8.8	8.0	8.6	8.1	[illegible]	
October Octobre	10.3	8.5	8.1	8.9	8.5	[illegible]	
November Novembre	10.3	8.6	8.7	9.5	8.0	[illegible]	
December [illegible]	13.5	10.5	12.6	12.9	13.1	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	

SALES PER SQUARE FOOT BY
VENTES PAR PIED CARRE PAR

Number of Stores Nombre de magasins	4		
Total Sales Per Square Foot Total des ventes par pied carré	$48.21		
Sales Volume Volume des ventes	$50,000-$100,000		
	Sales % des Ventes	Space % de la Superficie	Sales per Square Foot Ventes par Pied Carré
Hardware Quincaillerie	26.7	26.2	$48.78
Housewares Articles Ménagers	15.8	20.7	36.54
Sporting Goods Articles de sport	5.9	5.0	49.10
Paint Peinture	15.4	11.6	64.05
Lawn & Gardent Jarden et parterre	7.4	8.0	44.99
Tools Outils	8.0	8.9	43.61
Plumbing Supplies Articles de plomberie	6.2	5.3	57.60
Miscellaneous Divers	14.6	13.4	52.44
Total	100.0	100.0	48.21

DEPARTMENT — BY SALES VOLUME
RAYON — PAR VOLUME DES VENTES

[illegible]	15			[illegible]			151		
	$58.95			[illegible]			$52.52		
[illegible]	$150,000-$200,000			[illegible]			National Average Moyenne Nationale		
	Sales % des Ventes	Space % de la Superficie	Sales per Square Foot Ventes par Pied Carré	[illegible]	[illegible]	[illegible]	Sales % des Ventes	Space % de la Superficie	Sales per Square Foot Ventes par Pied Carré
[illegible]	23.4	24.8	$55.72	[illegible]	[illegible]	[illegible]	26.2	27.0	$54.79
[illegible]	14.6	18.3	47.17	[illegible]	[illegible]	[illegible]	16.2	20.3	45.17
[illegible]	[illegible]	8.9	65.68	[illegible]	[illegible]	[illegible]	6.4	5.8	62.37
[illegible]	[illegible]	9.2	85.33	[illegible]	[illegible]	[illegible]	14.6	11.2	73.82
[illegible]	7.3	6.3	68.35	[illegible]	[illegible]	[illegible]	7.0	7.3	55.38
[illegible]	7.9	9.4	49.66	[illegible]	[illegible]	[illegible]	7.8	8.8	50.26
[illegible]	6.1	5.6	64.24	[illegible]	[illegible]	[illegible]	6.3	5.2	68.04
[illegible]	[illegible]	17.5	58.44	[illegible]	[illegible]	[illegible]	15.5	14.4	60.68
[illegible]	100.0	100.0	58.95	[illegible]	[illegible]	[illegible]	100.0	100.0	52.52

COMPARISON OF 110
COMPARAISON ENTRE 110

Based Upon 110 Identical Stores Reporting For Two Consecutive Years. Basée sur deux ans de rapports consécutifs par 110 magasins semblables.	ATLANTIC PROVINCES PROVINCES MARITIMES		QUEBEC	
Number Of Stores • Nombre de magasins	6		20	
Year • Année	1968	1967	1968	1967
Total Sales: Total des ventes:	209,233	198,641	175,492	157,410
Cost of Goods Sold Coût des marchandises vendues	158,058	149,871	128,148	113,203
Gross Profit on Sales Profit brut sur les ventes	51,175	48,770	47,344	44,207
Expenses: Dépenses:				
Employee Wages Salaires des employés	20,997	17,713	16,720	14,962
Proprietor's Drawings or Manager's Salary Prélèvements du propriétaire ou salaire du gérant	5,917	7,932	8,894	8,222
Costs of Occupancy or Rent Frais d'occupation ou de location	3,423	4,112	4,451	3,797
Avertising Publicité	2,069	1,702	1,925	1,735
Delivery Costs Frais de livraison	1,354	[illegible]	1,317	1,334
Depreciation – Store Fixtures Amortissement – ameublement de magasin	1,190	425	604	555
Depreciation – Delivery Equipment Amortissement – équipement de livraison	[illegible]	[illegible]	865	734
Heat, Light, Power Chauffage, éclairage, électricité	1,274	1,078	924	977
Lic. & Bus. Taxes * Licences et taxes d'aff. *	1,252	525	449	406
Insurance (not on building) Assurance (non sur l'édifice)	959	[illegible]	1,172	915
Interest Paid on Borrowed Capital Intérêt payé sur capital emprunté	1,675	1,665	381	303
Repairs and Maintenance Réparations et entretien	468	424	610	[illegible]
Telephone Téléphone	604	460	475	583
Bad Debts Written Off Dettes non récupérables	[illegible]	882	269	472
Accounting and Auditing Comptabilité et vérification	790	603	1,039	370
Miscellaneous Divers	3,232	3,184	1,877	1,477
Total Expenses: Total des dépenses	47,958	43,001	42,572	38,297
Net Profit: Profit net	3,217	5,769	4,772	5,910
Other Income Autres revenus	2,224	2,397	694	1,113
Net Income Before Income Taxes Total des gains des propriétaires par rapport aux ventes	5,441	8,166	5,466	7,023
Proprietor's Total Return Compared to Sales Total des gains des proprétaires par rapport aux ventes	11,358	16,098	14,360	15,345
Inventory to Cost of Sales (turnover) Stocks au coût des ventes (chiffre d'affaires)	57,830	53,962	47,577	45,205

* not realty or income taxes * non l'imp. foncier ou sur le rev

IMILAR STORES
MAGASINS SEMBLABLES

ONTARIO				PRAIRIE PROVINCES PRAIRIES				BRITISH COLUMBIA COLOMBIE BRITANNIQUE				CANADA			
57				18				14				110			
1968		1967		1968		1967		1968		1967		1968		1967	
[illegible]	[illegible]	116,537	[illegible]	212,321	[illegible]	216,351	100.0	209,536	100.0	208,096	100.0	160,895	100.0	151,896	100.0
[illegible]	[illegible]	82,095	[illegible]	153,366	72.2	158,802	73.4	142,281	67.9	141,077	67.8	114,761	71.3	108,020	71.1
[illegible]	[illegible]	34,442	[illegible]	58,955	27.8	57,549	26.6	67,255	32.1	67,019	32.2	46,134	[illegible]	43,876	28.9
[illegible]	[illegible]	10,163	[illegible]	23,641	[illegible]	19,413	[illegible]	23,146	11.0	22,760	[illegible]	15,860	[illegible]	14,144	[illegible]
[illegible]	[illegible]	8,921	[illegible]	8,077	[illegible]	7,823	[illegible]	11,534	[illegible]	10,714	[illegible]	8,842	[illegible]	8,839	[illegible]
[illegible]	[illegible]	3,263	[illegible]	6,467	[illegible]	5,683	[illegible]	4,894	[illegible]	5,892	[illegible]	3,858	[illegible]	4,027	[illegible]
[illegible]	[illegible]	1,250	[illegible]	4,759	[illegible]	3,392	[illegible]	2,398	[illegible]	2,278	[illegible]	2,083	[illegible]	1,747	[illegible]
1,116	[illegible]	936	[illegible]	2,049	[illegible]	1,407	0.7	1,632	0.8	2,653	[illegible]	1,342	[illegible]	1,292	0.9
[illegible]	[illegible]	443	[illegible]	768	0.4	788	0.4	507	[illegible]	747	[illegible]	708	[illegible]	542	[illegible]
[illegible]	[illegible]	577	[illegible]	374	[illegible]	306	[illegible]	796	[illegible]	507	[illegible]	689	[illegible]	568	[illegible]
761	[illegible]	673	[illegible]	1,022	[illegible]	1,153	[illegible]	895	[illegible]	1,058	[illegible]	866	[illegible]	856	[illegible]
[illegible]	[illegible]	373	[illegible]	659	[illegible]	726	[illegible]	308	[illegible]	264	0.1	590	[illegible]	418	[illegible]
572	[illegible]	557	[illegible]	509	[illegible]	809	[illegible]	898	[illegible]	734	[illegible]	731	[illegible]	675	[illegible]
567	[illegible]	590	[illegible]	842	[illegible]	527	[illegible]	1,064	[illegible]	1,503	[illegible]	798	[illegible]	814	[illegible]
[illegible]	[illegible]	260	[illegible]	931	[illegible]	631	[illegible]	918	[illegible]	1,110	[illegible]	568	[illegible]	529	[illegible]
[illegible]	[illegible]	376	[illegible]	731	[illegible]	906	[illegible]	624	[illegible]	661	[illegible]	473	[illegible]	517	[illegible]
633	[illegible]	462	[illegible]	414	[illegible]	868	[illegible]	1,733	[illegible]	754	[illegible]	719	[illegible]	572	0.4
[illegible]	[illegible]	366	[illegible]	1,221	[illegible]	1,607	0.7	388	[illegible]	1,939	[illegible]	628	[illegible]	726	[illegible]
1,541	[illegible]	1,551	[illegible]	4,910	[illegible]	5,067	[illegible]	7,191	[illegible]	3,262	[illegible]	2,812	[illegible]	2,259	[illegible]
[illegible]	[illegible]	30,766	[illegible]	57,374	[illegible]	51,106	[illegible]	58,926	[illegible]	56,836	[illegible]	41,567	[illegible]	38,525	[illegible]
[illegible]	[illegible]	3,676	[illegible]	1,581	[illegible]	6,443	[illegible]	8,329	[illegible]	10,183	[illegible]	4,567	[illegible]	5,351	[illegible]
[illegible]	[illegible]	1,142	[illegible]	5,159	[illegible]	2,576	[illegible]	2,884	[illegible]	2,073	[illegible]	1,917	[illegible]	1,493	[illegible]
[illegible]	[illegible]	4,816	[illegible]	6,740	[illegible]	9,019	[illegible]	11,213	[illegible]	12,256	[illegible]	6,484	[illegible]	6,844	[illegible]
[illegible]	[illegible]	13,739	[illegible]	14,817	[illegible]	16,842	[illegible]	22,748	[illegible]	22,970	[illegible]	15,326	[illegible]	15,683	[illegible]
[illegible]	[illegible]	36,454	[illegible]	75,456	[illegible] Times	75,390	[illegible] Times	47,215	3.4 Times	57,808	[illegible] Times	47,215	[illegible] Times	46,865	[illegible] Times

1968 PROFIT MAKERS

The Profit Makers are Stores earning better than a 25% return on investment

	QUEBEC		ONTARIO	
Number of Stores • Nombre de Magasins	4	35	17	63
	Profit Makers Magasins rentables	Others Autres	Profit Makers Magasins rentables	Others Autres
Total Sales: Total des ventes:	$217,571	$180,350	$154,105	$122,943
Cost of Goods Sold Coût des marchandises vendues	158,021	131,489	108,972	85,990
Gross Profit on Sales Profit brut sur les ventes	59,550	48,861	45,133	36,953
Expenses: Depenses:				
Employee Wages Salaires des employés	19,323	17,475	13,113	12,412
Proprietor's Drawings or Manager's Salary Prélèvements du propriétaire ou salaire du gérant	8,798	8,446	8,494	8,347
Costs of Occupancy or Rent Frais d'occupation ou de location	6,925	4,501	3,089	3,484
Avertising Publicité	2,267	1,867	1,789	1,367
Delivery Costs Frais de livraison	1,907	1,476	864	1,167
Depreciation – Store Fixtures Amortissement – ameublement de magasin	711	582	526	676
Depreciation – Delivery Equipment Amortissement – équipement de livraison	489	916	475	537
Heat, Light, Power Chauffage, éclairage, électricité	1,370	984	736	774
Lic. & Bus. Taxes * Licences et taxes d'aff. *	406	457	459	583
Insurance (not on building) Assurance (non sur l'édifice)	1,110	1,225	572	537
Interest Paid on Borrowed Capital Intérêt payé sur capital emprunté	1,096	923	608	683
Repairs and Maintenance Réparations et entretien	578	718	315	358
Telephone Téléphone	639	547	342	362
Bad Debts Written Off Dettes non récupérables	556	627	578	573
Accounting and Auditing Comptabilité et vérification	637	1,227	319	409
Miscellaneous Divers	1,180	2,608	1,609	1,564
Total Expenses: Total des dépenses	47,992	44,599	33,940	33,833
Net Profit: Profit net	11,558	4,262	11,193	3,120
Other Income Autres revenus	689	1,076	1,491	1,005
Net Income Before Income Taxes Total des gains des propriétaires par rapport aux ventes	12,247	5,338	12,684	4,125
Proprietor's Total Return Compared to Sales Total des gains des proprétaires par rapport aux ventes	21,045	13,784	21,178	12,472
Inventory to Cost of Sales (turnover) Stocks au coût des ventes (chiffre d'affaires)	52,741	50,840	46,506	40,260

* not realty or income taxes * non l'imp. foncier ou sur le rev.

MAGASINS RENTABLES EN 1968

Magasins Rentables sont ceux qui réalisent plus de 25% de retour sur l'investissement

B.C. C.B.				CANADA				SHOPPING CENTRE STORES	
5		21		32		158		23	
Profit Makers Magasins rentables		Others Autres		Profit Makers Magasins rentables		Others Autres		MAGASINS DE CENTRES D'ACHATS	
$166,516	[illegible]	$178,890	100%	$185,223	100%	$162,201	100%	$158,560	100%
104,042	[illegible]	123,373	[illegible]	130,675	70.5	116,049	71.5	113,477	71.6
62,474	[illegible]	55,517	[illegible]	54,548	29.5	46,152	28.5	45,083	28.4
11,710	[illegible]	19,234	[illegible]	16,506	[illegible]	16,330	[illegible]	12,182	7.7
[illegible]	[illegible]	10,556	[illegible]	8,155	[illegible]	8,775	[illegible]	9,296	[illegible]
5,664	[illegible]	4,480	[illegible]	4,771	[illegible]	4,175	[illegible]	5,392	[illegible]
3,016	[illegible]	2,508	[illegible]	2,141	[illegible]	1,975	[illegible]	1,839	[illegible]
[illegible]	[illegible]	1,457	[illegible]	1,027	[illegible]	1,390	[illegible]	910	0.6
[illegible]	[illegible]	641	[illegible]	656	[illegible]	679	[illegible]	746	[illegible]
[illegible]	[illegible]	659	[illegible]	510	[illegible]	702	[illegible]	501	[illegible]
[illegible]	[illegible]	952	[illegible]	937	[illegible]	942	[illegible]	1,046	[illegible]
[illegible]	[illegible]	227	[illegible]	459	[illegible]	515	[illegible]	332	[illegible]
[illegible]	[illegible]	769	[illegible]	694	[illegible]	736	[illegible]	632	[illegible]
[illegible]	[illegible]	1,261	[illegible]	903	[illegible]	875	[illegible]	812	[illegible]
[illegible]	[illegible]	320	[illegible]	351	[illegible]	592	[illegible]	743	[illegible]
[illegible]	[illegible]	597	[illegible]	535	[illegible]	502	[illegible]	453	[illegible]
[illegible]	[illegible]	1,329	[illegible]	743	[illegible]	704	[illegible]	336	[illegible]
[illegible]	[illegible]	446	[illegible]	1,153	[illegible]	668	[illegible]	498	[illegible]
[illegible]	[illegible]	5,538	[illegible]	2,178	[illegible]	2,563	[illegible]	1,747	[illegible]
[illegible]	[illegible]	51,474	[illegible]	41,719	[illegible]	42,123	[illegible]	37,465	[illegible]
[illegible]	[illegible]	4,043	[illegible]	12,829	[illegible]	4,029	[illegible]	7,618	[illegible]
[illegible]	[illegible]	2,508	[illegible]	1,256	[illegible]	1,715	[illegible]	1,285	[illegible]
[illegible]	[illegible]	6,551	[illegible]	14,085	[illegible]	5,744	[illegible]	8,903	[illegible]
[illegible]	[illegible]	17,107	[illegible]	22,240	[illegible]	14,519	[illegible]	18,199	[illegible]
[illegible]	[illegible]	56,219	[illegible]	55,990	Times [illegible] Fois	48,609	Times 3.3 Fois	49,699	Times 3.2 Fois

SIGNIFICANT MANAGEMENT
RAPPORTS DE CONTROLE DE

	Data Source Source d'Information	Method of Calculation Méthode de Calcul
RETURN ON INVESTMENT RETOUR SUR L'[illegible]	[illegible]	[illegible]
OWNERSHIP PERCENTAGE POURCENTAGE DU PROPRIÉTAIRE	Balance Sheet Bilan	OWNERS EQUITY / Total Assets AVOIR DU PROPRIÉTAIRE / Actif Total
WORKING CAPITAL [illegible] ROULEMENT DU [illegible]	[illegible]	[illegible]
CURRENT ASSET RATIO RAPPORT DE L'ACTIF COURANT	Balance Sheet Bilan	CURRENT ASSETS / Current Debt ACTIF COURANT / Dettes actives
QUICK ASSET RATIO RAPPORT DE L'ACTI[illegible]	[illegible]	[illegible]
INVENTORY TURNOVER ROULEMENT DE L'INVENTAIRE	Income Statement Relevé du Revenu	INVENTORY VALUED AT COST / Cost of Merchandise Sold INVENTAIRE AU COÛT / Coût des Marchandises Vendues
AVERAGE YEARLY SALES PER EMPLOYEE VENTES [illegible] EMPLOYÉ	[illegible]	[illegible]
AVERAGE YEARLY SALES PER SQ. FT. VENTES MOYENNES PAR PIED CARRÉ	Income Statement Relevé du Revenu	NET SALES / Total Sales Floor and Warehouse area in Sq. Ft. VENTES NETTES / Superficie totale de vente et d'entrepôt en pieds carrés
AVERAGE VALUE OF EACH [illegible] VALEUR MOYENNE [illegible] TRANSACTION	[illegible]	[illegible]
AVERAGE AGE OF ACCOUNTS RECEIVABLE AGE MOYEN DES COMPTES À PERCEVOIR	Income Statement & Balance Sheet Relevé du Revenu et bilan	AVERAGE DAILY CHARGE SALES / Average Total Accounts Receivable MOYENNE JOURNALIÈRE DE VENTES À CRÉDIT / Total Moyen des Comptes à percevoir.

CONTROL RATIOS
GESTION SIGNIFICATIFS

190 Stores All Store Average 190 Magasins Moyenne de tous Magasins	31 Stores Profit Makers 31 Magasins Magasins Rentables	22 Stores Shopping Centres 22 Magasins Centres d'Achats	Suggested Range Classe suggérée
[illegible]			
60.7%	44.4%	57.3%	Between 50% & 70% Entre 50% & 70%
[illegible]			
[illegible] : 1	2.5 : 1	2.9 : 1	Between 4 : 1 & 7 : 1 Entre 4 : 1 & 7 : 1
[illegible]			
2.3 Turns 2.3 Tours	2.3 Turns 2.3 Tours	2.1 Turns 2.1 Tours	Between 2 & 3 Turns Entre 2 & 3 Tours
[illegible]			
[illegible]	$53.81	$44.61	Between $50.00 & $75.00 Entre $50.00 & $75.00
[illegible]			
72 Days 72 Jours	78 Days 78 Jours	48 Days 48 Jours	Depends on type of Credit offered Dépend de la sorte de crédit offert

The data contained herein was compiled by the Canadian Retail Hardware Association, 290 Merton Street, Toronto 7, Ontario. We are very grateful to those members who responded to the 1968 Survey questionnaire, and by their actions, made this project possible.
Distribution to other than member stores, $3.00 per copy.

Les renseignements contenus dans cette brochure ont été compilés par l'Association Canadienne des Détaillants en Quincaillerie, 290 Merton Street, Toronto 7, Ontario. Nous remercions tous les membres qui ont bien voulu remplir le questionnaire de l'enquête de 1968 et qui, du fait même, ont ainsi rendu possible la réalisation de ce projet.
Distribution aux magasins ne faisant par partie de l'Association: $3.00 per exemplaire.

APPENDIX "B"

NAME: CANADIAN RETAIL HARDWARE ASSOCIATION

SUBJECT: Taxation of Small Businesses and other related subjects

Analysis of Appendix "A" by Senior Advisor

This brief has been submitted by the Canadian Retail Hardware Association.

The Association is a voluntary trade organization of about 1400 members, all of whom are independent retail hardware stores.

The principal opinions expressed in the brief are:

"S.2 The association finds in the White Paper bias against small businessmen, unintentional as it may be. We suggest that the document was prepared by people familiar with large-scale operations to meet criteria dictated by such firms. Our contention is that the small businessman was "fitted into" a structure which was quite oblivious to his special needs."

"S.3 There are grave dangers in the White Paper proposals for the hardware retailer. The elimination of the two-tiered system of corporate tax will severely restrict the retailer's chief source of expansion capital - after-tax corporate profits. As well as restricting his means to expand, the incentive to expand through partial tax deferral under the present system will be removed. A considerable proportion of the incentive to enter the high-risk, long-hour retail trade is also removed. The consequences, we suggest, will lead to fewer and more static retail outlets."

"S.6 We sincerely question the application of the capital gains tax at full personal marginal tax rates since, to some extent at least, it is a tax on inflated values."

"S.7 We foresee the end of family-owned hardware businesses at the end of the present generation as a consequence of both the White Paper proposals and the year-old estate and gift taxes. If the next generation can afford to take over their fathers' stores, the lack of incentive will deter them from doing so."

"S.8 We are concerned also with the White Paper's attitude toward the expense of attendance at conventions and seminars. We wonder at the logic that leads the proposals to suggest taxation of investment income of non-profit organizations while exempting labour and religious organizations. Because our members compete with co-operatives, they cannot understand the stance of the White Paper in recognizing the special privileges of these organizations but removing only some of them. "

"S.9 The hardware retailer as a small businessman seems to feel the effects of most of the changes proposed in the White Paper. He is a member of the middle-income group so he will feel the weight of increased personal tax rates. He is a small businessman so he will suffer a considerable increase in corporation taxes. Often he owns the building in which his store is located so in this way, and others, he will face capital gains taxes. Since he is independent and depends on conventions and seminars to increase his expertise, he will be affected by this and other disallowed expenses. "

"S.13 More than anything else, we plead for reason and restraint. Although the present tax system has many faults, it has allowed notable progress in the development of one of the highest standards of living in the world today. We plead that it be revised in simple and gradual units of reform. The hardware retailer might not survive such a violent upheaval in the taxation system as that contained in the White Paper; we suggest that the Country might not either, and we ask whether our present tax structure is so bad that we must rush recklessly into such traumatic change."

The brief itself comprises:

1. A summary.
2. A foreword
3. An introduction describing the Association and the nature of hardware retailing (Pages 1 to 4)
4. A section dealing with the taxation of small businesses (Pages 5 to 19)
5. A section dealing with the capital gains tax (Pages 20 to 25)
6. A section dealing with Convention expenses (Pages 26 to 28)
7. A section dealing with Co-operatives (Pages 29 and 30)
8. A section dealing with the proposed tax on the investment income of associations (Pages 31 and 32)
9. A section dealing with the impact of the White Paper proposals on the retail hardware merchant (Pages 33 to 43)
10. A summary of the recommendations contained in the brief (Pages 44 to 47)

The summary of the recommendations is as follows:

"SECTION 9.

A SUMMARY OF RECOMMENDATIONS

9.1 The Canadian Retail Hardware Association begs to present the following recommendations in respect to the proposals contained in the White Paper on Tax Reform:

9.2 That the government abandon thoughts of dramatic change of a tax system that has served the country remarkably well, and proceed with orderly and cautious tax reform in order to preserve the stability of the economy and the balances within it while gradually serving the needs of the day.

9.3 That the proposal to eliminate the present two-tiered system of corporate taxation be abandoned and that a preferential corporate tax rate on the first $35,000.00 of corporate profits be retained as essential to the growth, incentive, viability and competitive position of small, relatively high-risk businesses.

9.4 That the categorization of corporations for tax purposes as closely-held and widely-held, regardless of scale or level of profits, be abandoned as regressive, and that the present progressive categorization based on level of corporate profits be maintained.

9.5 That accelerated capital-cost allowances for small businesses be considered and implemented as a needed stimulus to small business expansion.

9.6 That the rate of taxation applied to capital gains be substantially lower than the personal marginal tax rate in recognition of the fact that, to some extent, it is a tax on inflated values.

9.7 That capital gains tax be not applied to surpluses of small businesses on their sale in recognition that the surplus is generated from tax-paid profits.

9.8 That if the preferred tax rate on the first $35,000.00 of corporate profits is removed, owners of small businesses be allowed to gain tax relief for monies left in the business in much the same manner as deposits in registered retirement savings plans are exempt from tax, in recognition of the fact that the business is often the sole source of retirement capital for small businessmen.

9.9 That capital gains tax not be applied on the sale of a business within a family if the original owner is forced to leave Canada for valid medical reasons.

9.10 That transfers of family businesses between generations be eased by the provision of low-cost government loans to allow the second generation to cover estate or gift tax without resorting to sale of the business.

9.11 That the proposal to disallow the cost of attendance at Conventions and Seminars as a legitimate expense of a business before tax be abandoned and the privilege of deducting such items from personal taxable income be allowed for employees in recognition that such expenses contribute to the knowledge and expertise of both the owner of a business and his employees.

9.12 That the proposal to impose a minimum stand-by charge on all businessmen who have minimal access to use of a company vehicle be abandoned in favour of individual rulings in each case in order to prevent penalizing those who use the vehicle other than by their own choice.

9.13 That the proposals to remove certain of the tax advantages enjoyed by co-operatives be extended to remove all advantages in recognition that co-operatives serve the same markets and compete directly with other types of business organizations.

9.14 That the proposal to tax investment income of associations and other non-profit groups while exempting labour unions and religious organizations be abandoned, but failing this, be applied equally to all non-profit organizations.

9.15 That the government seek more meaningful dialogue on tax reform through its introduction in easily understandable units rather than the introduction of a complicated set of inter-dependent proposals toward which even tax experts cannot find general agreement.

9.16 That the government assure the people of Canada of some stability in tax structure within which businessmen and individuals may confidently plan necessary or desired long-term commitments in recognition of the fact that turmoil in the tax structure causes severe hardships for those who have entered such agreements.

9.17 That the government clearly and concisely outline its need for an ever-increasing proportion of the Gross National Product of Canada whenever tax increases are proposed or implemented.

All of which is respectfully submitted

CANADIAN RETAIL HARDWARE ASSOCIATION. "

There is attached the usual summary of present tax laws, White Paper proposals and the principal points of the brief.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Lower Rate of Tax on first $35,000. of taxable Income of Corporations

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 39-1 of the Income Tax Act. This section of the Act provides that all corporations other than associated companies shall pay taxes of (1) 21% of the first $35,000 of taxable income and (2) 52% of any excess taxable income.	4.30 It is therefore proposed that the low rate be removed from the business profits of small corporations gradually over a period of five years. For corporations with taxable business profits not greater than $35,000 the low rate would apply to $28,000 in the first year of transition, $21,000 in the second, $14,000 in the third, $7,000 in the fourth, and be eliminated entirely in the fifth year. For corporations with taxable business profits above $35,000, the amount subject to the low rate would be reduced more quickly the more the corporation's taxable profits exceed $35,000. The benefit would be removed immediately if taxable business profits equal or exceed $105,000. In other words, the larger the corporation the more quickly it would lose the benefit designed for small corporations. 4.31 The precise formula would remove 80 cents of a corporation's entitlement to be taxed at the low rate for each $2 of business income in excess of $35,000 in the first year of transition. In the second year the reduction would be 60 cents for each $2; in the third year, 40 cents for each $2; and in the fourth year, 20 cents for each $2. In the meantime the maximum entitlement would be reduced, so that the effect would be a	Pages 5 to 17 Section 2 of Brief This portion of the brief states: 2.1 Underlying the White Paper proposals in the area of corporation tax, is a new method of categorization of corporations for tax purposes. This new system uses the character of the corporation (closely or widely-held) rather than its level of income. 2.2 We are distressed to see this aspect of the proposals defended so vociferously by the tax planners, and our distress is multiplied when we hear critics of the proposals often defend this point. 2.5 The White Paper in its proposed categorization which affects tax credits of shareholders, differentiates between corporations solely on the basis of the character of the corporation with no regard to its size or earnings. This seems regressive and unfair to us.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Lower Rate of Tax on first $35,000. of Taxable Income of Corporations

Present Tax Law	White Paper Proposals	Principal Points of Brief
	gradual reduction in the amounts subject to the low rate of tax. For example, a company with taxable business profits of $85,000 in each of the first five years of the new system would be entitled to have $8,000 taxed at the low rate in the first year, $6,000 in the second year, $4,000 in the third year, $2,000 in the fourth year and nothing the fifth year. On the other hand, a corporation that earns $45,000 in each of the first five years would be entitled to have $24,000, $18,000, $12,000, $6,000 and zero taxed at the low rates.	2.10 The present two-tier system of corporate tax based on corporate profit levels recognizes ability to pay which should always remain an objective of progressive taxation. It must be maintained. 2.18 The inability to partially delay taxes on corporate profits will have its greatest effect on small businesses because all of their profits fall below the level where the present lower rate of corporate tax applies. 2.19 Small businesses rely heavily on profits to finance expansion and growth. The small corporation doesn't have access to sophisticated capital markets. The capital needs of small corporations are served by the personal equity of the owners, after-tax profits and loan capital which is expensive because of the degree of risk. The owners' equity is limited and year-by-year growth has, of necessity, been financed out of after-tax dollars allowed to remain in the business.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Lower Rate of Tax on first $35,000. of Taxable Income of Corporations

Present Tax Law	White Paper Proposals	Principal Points of Brief
		2.20 The White Paper proposals will diminish the most important source of expansion capital available to the retail corporation. The corner hardware store can't sell stock to raise equity capital. He can't sell a bond or debenture at realistic interest rates. He must rely on profits and profits will be effectively drained away by the new tax structure. (See Table 1) "See Page 10 of Brief". 2.22 There isn't the slightest doubt in our minds that the White Paper corporate tax proposals will inhibit the growth of small corporations. We suggest that this would be an accomplishment of doubtful merit. 2.24 The White Paper in one stroke proposes to reduce both the ability to expand and the incentive to do so by small corporations. 2.25 The White Paper proposals, if implemented in their present form, will have the effect of changing the rules in the middle of the game for many hardware retailers. We have heard from many of our members who incurred inflexible long-term obligations upon entering the hardware business. These commitments are being retired, as the

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Lower Rate of Tax on first $35,000. of Taxable Income of Corporations

Present Tax Law	White Paper Proposals	Principal Points of Brief
		years pass, out of profits. They are uncertain as to their ability to continue if the rules are changed as contemplated. 2.26 We believe that it is reasonable to assume a certain degree of stability will be afforded by the government in its tax structure when entering long-term arrangements of this sort. Radical re-alignment may therefore be interpreted as a breach of faith. 2.31 The proposal to allow closely-held corporations to be taxed at the individual tax rates of the owners (i.e. to be taxed as partnerships) gives this category of corporation a certain advantage over widely-held corporations. The advantage does not compensate for the removal of the 21% corporate tax however, because an individual would have to have a taxable income of $3,000.00 or less to obtain the same low rate of tax.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Lower Rate of Tax on first $35,000. of Taxable Income of Corporations

Present Tax Law	White Paper Proposals	Principal Points of Brief
		2.34 There has been much debate over whether or not the White Paper proposals are inflationary. To the hardware retailer, the answer is clear. 2.36 This process would invariably lead to higher retail prices for the goods and services offered in his establishment. There is no question that the corporate tax reform proposed in the White Paper would have an inflationary effect on retail prices. 2.39 The decision of a small business to incorporate or not has been voluntary. It has been accomplished in the vast majority of cases where expansion capital was required. There never has been a distinct tax advantage to incorporation for the business from which profits were stripped yearly. 2.42 One effect is a virtual certainty. The small corporations will grow less numerous simply because the greater part of the incentive to incorporate will have been removed.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: The Capital Gains Tax

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not impose any tax on capital gains.	The proposals to tax capital gains are contained in Chapter 3 of the White Paper	Pages 20 to 25, Section 3 of Brief This section of the brief states: 3.8 The weight of the capital gains tax, whatever the corporate tax structure, would fall on those retail corporations which own the one fixed asset which can and does often appreciate in value - the store building and the land on which it is built. Any increase in value of this asset after valuation day would be subject to capital gains tax when it was sold. 3.10 Estate duties now have considerable weight in this country. Usually, an heir is left in the position of having to sell a portion of the business in order to meet these obligations. If this is done, capital gains tax immediately becomes payable and compounds the problem confronting the heirs. In another example, if the owner of a business is forced to sell for reasons of health and move to a warmer climate outside of Canada, he is faced with the capital gains tax. 3.11 We are concerned also that capital gains tax is to be applied at full personal tax rates rather than at a lower rate as is in existence in the United States. In effect, because the capital gain of a retailer selling his store will come all at once, this

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: The Capital Gains Tax

Present Tax Law	White Paper Proposals	Principal Points of Brief
		provision decrees that the selling retailer will pay 50% tax on his capital gain. We consider this to be a severe deterrent to the accumulation of worth within a business. We are further disturbed that although the White Paper proposes the full weight of personal tax rates, it makes no provision for any credit in respect to taxes paid by the business over the years. 3.13 Earlier herein we have explained that the capital gains tax will only be felt by hardware retailers under present corporate tax structure and will be negligible if the White Paper proposals on corporate tax are adopted. In an earlier section of the brief, we have advised strongly against departure from the present two-tiered system of corporate tax. In combination, these factors suggest that we are prepared to accept a heavier weight of capital gains tax if present corporate tax structure is maintained. 3.14 Hardware retailers do not want a capital gains tax. This type of tax, however, is somewhat less noxious to them than the removal of the two-tiered corporate tax base.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: The Capital Gains Tax.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		3.15 If a tax on capital gains is implemented, we believe that the method proposed in the White Paper should be severely modified in order to prevent critical problems for small businessmen.
		3.16 Capital gains tax should not be imposed at full personal tax rates but at some lower rate which recognizes that to a certain extent at least it is a tax on inflated values.
		3.17 The surplus which builds up in small incorporated businesses represents profits on which corporate tax has been paid. No capital gains tax should be applied to such amounts when the business is sold.
		3.18 If a capital gains tax is applied, serious consideration should be given to allowing tax relief on capital deposited in the business much as is the case in registered retirement savings plans, since the business often constitutes a retailer's retirement fund.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: The Capital Gains Tax

Present Tax Law	White Paper Proposals	Principal Points of Brief
		3.19 In the case where a family corporation is passed to heirs, the government should consider allowing the heirs to pay estate duties over a prolonged period of years at nominal interest in order to prevent forced sale and burden of capital gains tax which in many cases would effectively prevent the heirs from continuing the business.

CANADIAN [illegible]

[illegible] Convention Expenses and Automobile Expenses

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act permits the deduction from income of reasonable amounts of expenditures on conventions and business promotion.	1.35 Various fringe benefits received by employees or by the owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yachts and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer.	Pages 26 to 28 Section 4 of Brief With respect to Convention Expenses this section of the brief states: 4.1 As an Association, we are concerned that the White Paper embodies in its discussion of Convention expenses the underlying philosophy that such meetings are wasteful in a business sense and are primarily geared to the pleasure and enjoyment of participants. We must strongly condemn this point of view and assert that it is false.
	2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or	4.3 This Association has an annual Convention. For those attending, it is not a pleasure trip. While it is true that an annual Banquet and Ball is held on one evening, it is also true that the daylight hours are filled with business-related activity, and another evening is devoted to the Association's Annual General Meeting.

Name: CANADIAN RETAIL HARDWARE EXPENSES

Principal Subject: Convention Expenses and Automobile Expenses

Present Tax Law	White Paper Proposals	Principal Points of Brief
	employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes. 5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	4.4 In addition, the Association organizes management development seminars for its members. The courses offered are of a week's duration and registrants are exposed to seventy hours of instruction in the seven-day period. They also find it necessary to spend evening hours preparing reports and assignments for the next day. Members attend these courses at considerable cost to their businesses and there is no social aspect whatever to their attendance. 4.7 We suggest that these proposals would have a very serious effect on the continued operation of trade or professional associations. We object most strenuously to the proposals and to the philosophy which seems to underlie them.

Name: CANADIAN RETAIL HARDWARE EXPENSES

Principal Subject: Convention Expenses and Automobile Expenses

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.	With respect to Automobile expenses this section of the brief states: 4.9 The White Paper proposes to institute a minimum stand-by charge for the use of a company vehicle to businessmen who drive the vehicle to and from their place of employment. 4.11 Insurance sources advise us that in many cases insurance rates on company vehicles would increase if they were to be left unattended in commercial areas at night and over weekends. Is the businessman to be penalized for driving a company vehicle to his residence more for its protection than for his own convenience? This is not an isolated case. Many hardware dealers live within easy walking distance of their stores but remove their business vehicle to their residence at night for its protection. 4.12 Many hardware dealers have an automobile for their personal use as well as a company vehicle. The second vehicle is required by the business and would not be existent otherwise. We believe that in such cases the business vehicle is a logical expense of the business whether or not it is driven home by the owner.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Co-operatives

Present Tax Law

The present Income Tax Act:

(a) Exempts from tax the the income of a new co-operative for a period of three years, and

(b) permits the deduction of patronage dividends from income, but such deduction cannot reduce the remaining income to less than 3% of capital employed.

White Paper Proposals

4.68 Two rules in the act have a special significance for co-operatives. One provides that a co-operative shall be exempt from income tax for the first three years of its existence. It is proposed that this exemption be withdrawn. If the rules that govern the tax position of co-operatives in the fourth and subsequent years are fair, they should apply to the first three years as well.

4.69 The second rule provides that patronage dividends are deductible in computing the taxable income of the co-operative, subject to a limit. Patronage dividends are deductible before interest paid (other than interest to a bank or credit union) and cannot reduce profits at that point in the computation below 3 per cent of capital employed. This might be thought to ensure that members are taxed on some return on their investment in the co-operative. However, the 3 per cent is far too low in current circumstances. Further, because such other debts as mortgages are taken into account in determining the capital employed, the effective interest taxed to members can be even lower than 3 per cent. (A $200,000 mortgage at an interest rate of 7½ per cent would result in no taxable return on members' investment of $300,000.)

Principal Points of Brief

Pages 29 and 30, Section 5 of Brief

This portion of the brief states:

5.1 In many locations in Canada, independent hardware retailers compete with consumer co-operatives in the sale of their normal stock-in-trade. It has always seemed incongruous to these dealers that the stores competing with them were afforded vast tax advantages simply because they were organized as consumer co-operatives. The advantages afforded co-operatives have stimulated phenomenal growth of these outlets over the years.

5.3 We were somewhat heartened to see that the White Paper proposes the elimination of one of the tax advantages enjoyed by co-operatives and proposes to compromise another.

5.4 The White Paper proposes to remove the existing three-year income tax exemption for new co-operatives and in this we heartily agree.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Co-operatives

Present Tax Law	White Paper Proposals	Principal Points of Brief
	4.70 The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans—that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends.	5.5 The White Paper also proposes to raise the limit on deductibility of patronage dividends before tax from the present minimum of 3% of capital employed to a somewhat higher rate which would vary with the interest rate on government bonds. We applaud this intent which certainly will lessen the tax advantage now enjoyed by co-operatives. At the same time we must admit to some disappointment that the inequities have not been removed in the proposals altogether. 5.7 The Association and its members stand inalterably opposed to income tax concessions for co-operatives in any degree. We endorse and support the brief of the Equitable Income Tax Foundation on this subject.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Tax on INvestment Income of Associations

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act exempts from tax the income of a non-profit association or corporation.	5.54 The present law contains a provision—section 62(1)(i)—that exempts from income tax social, recreational and service clubs, societies and associations which operate on a non-profit basis. (This provision does not cover registered charities which are exempted under other paragraphs.) The government does not propose to change the exempt status of the basic functions of these organizations, but when they accumulate investment portfolios, it believes that the investment income therefrom should bear income tax. Therefore it is proposed that the investment income of organizations which are covered by section 62(1)(i) be subjected to the corporation tax. 4.60 The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities.	Pages 31 and 32, Section 6 of Brief This portion of the brief states: 6.1 The White Paper proposes to tax at full rates the investment income of non-profit organizations such as Associations. As might be expected, we are opposed to such a move. 6.5 This Association received investment income during 1969 of about $8,000.00. The year ended with an overall surplus of less than $1,000.00. If we had been forced to pay tax at corporate rates on our investment income as proposed by the White Paper, we would have either ended the year with a deficit of $3,000.00 or would have had to compromise our membership services.

Name: CANADIAN RETAIL HARDWARE ASSOCIATION

Principal Subject: Tax on Investment Income of Associations

Present Tax Law	White Paper Proposals	Principal Points of Brief
		6.7 Associations being non-profit in nature are not required to pay tax. It follows from this that they may not be able to charge the cost of their investment programmes to the income produced before tax. 6.8 We fail to understand the logic of requiring any organization to pay tax on one portion of its income regardless of the overall profitability of that organization.

APPENDIX "C"

PAUL NOISEUX, C.A.
ROGER LYONNAIS, C.A.
LIONEL GASCON, C.A.
PIERRE BEDARD, LL.L, C.A.
JEAN LUSSIER, C.A.
RENÉ SENECAL, C.A.
MARCEL DEMERS, C.A.
ANDRÉ ROCHETTE, C.A.
GEORGES AUDET, C.A.
GILLES POUPART, C.A.
ANDRÉ LUSSIER, C.A.
MICHELLE HARDY, C.A.
MARCEL LECOURT, C.A.

NOISEUX, LYONNAIS, GASCON, BÉDARD, LUSSIER, SENÉCAL & ASSOCIÉS

COMPTABLES AGRÉÉS–CHARTERED ACCOUNTANTS

215 RUE ST-JACQUES, MONTRÉAL — TÉL. 849-7791

A PRESENTATION TO THE SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE.

Subject

The effects on closely-held corporations of the removal of the reduced rate of corporation tax on the first $35,000 of profits.

Effects

Additional taxes of $452 million annually paid out by small companies as follows:

(A) Removal of the reduced rate on the first $35,000 in profits	
1st year - 50% of $95 million	$ 47 million
2nd to 5th years	295 million
(B) Taxing of dividends received by closely-held corporations	60 million
(C) Capital gains (50% of $100 million)	50 million
	$ 452 million

It is reasonable to believe that small corporations will bear 80% of the burden of the anticipated increase in taxes on corporate income. The increase is not compensated for by any reduction in the taxes paid by shareholders. Tax relief is proposed for by taxpayers in some categories by such measures as raising personal exemptions and setting a 50% limit on the marginal rate. We may therefore expect that those holding shares in small corporations will be in the $10,000 to $30,000 income bracket, where taxes will be increased.

Example

The taxation of a corporation that has a $35,000 profit after paying a $15,000 salary to its principal shareholder:

Taxes paid by the corporation and the shareholder in question jointly:

1969 - present rates	$ 11,851
1974 - proposed rates	21,624
INCREASE (close to 100%)	$ 9,773

Withdrawal by the tax authorities of $452 million annually in reinvestment in the form of profits or in the equity business.

The possibility of an equivalent withdrawal of $452 million annually in investment in the form of long-term loans; The I.D.B., the Industrial Credit Office of Quebec, Roy-Nat and other lending institutions generally required that equity capital be greater than the loans they grant.

This amounts to almost a billion dollars a year taken out of the hands of small businessmen, who need these resources in order to finance growth.

Small businesses cannot seek capital on the open market. $200,000 would seem to be the sallest issue that can be handled efficiently; the costs of administering anything less are prohibitive.

Consequences

The probable disappearance of the small business, controlled by Canadians, in favour of the large and generally foreign-owned corporation.

Reasons for Protecting Small Businesses.

(A) Genuine innovation that demonstrates the original thinking and native ingenuity of Canadians is more characteristic of the small corporation.

(B) Lower costs make possible price competition with big business.

(C) The establishment of growth of small companies bode well for the establishment of large ones.

(D) Small businesses are Canadian-owned. Can we say as much of the large ones?

(E) Small businesses create jobs. The 1964 figures show that at that time, 45.9% of jobs in the manufacturing industries were created by firms employing fewer than 200.

(F) In, 1949, 1953, 1957 and 1959, the various Ministers of Finance explicitly recognized the need to protect small businesses.

(G) The Carter Report, which devotes more than 100 pages to the problems of small businesses, recommends the abolition of the reduced rate, but it suggests some substantial compensations.

Noiseux, Lyonnais, Gascon, Bedard, Lussier,
Senecal & Associes,
Chartered Accountants.

Montreal, February 20th, 1970.

Mr. Chairman,

Members of the Committee,

Allow us to introduce ourselves. We are a firm of chartered accountants, established in 1945, and doing business as "Noiseux, Lyonnais, Gascon, Bedard, Lussier, Senecal & Associes". We have a staff of fifty-five, seventeen of whom are chartered accountants.

Our firm's research committee has made a very close study of the proposals for tax reform, and we have some submissions to make to you.

We are in agreement with the general principles of fairness that appear to underlie the reform proposals, but a number of aspects of the changes that are suggested require comment. Our business clients are small companies that inevitably evolve into "closely-held corporations", and we have been involved with most of them since their earliest days. We wish to confine our remarks to the proposed abolition of the reduced rate of corporation tax on the first $35,000 of annual profits.

How will the White Paper proposals affect the amount of tax paid by the corporations? Referring to Table 16 of the White Paper, we note that at the end of the fifth year of implementation of the proposals, corporation tax revenue will increase by $560 million.

Abolition of the reduced rate will affect both widely- and closely-held corporations; Table 16 anticipates that the increase in tax revenues as a result of the abolition will be $95 million in the first year. Part of this amount will come from large corporations, but from the second to the fifth year, the entire increase can come only from the small ones, since the advantages of the lower rate are eliminated in the first year for a coporation with income in excess of $105,000.

Table 16 shows that the removal of the low rate will increase tax revenues by $390 million in the fifth year. If the advantages of the low rate for large corporations disappear in the first year, it is the small ones that will bear the cost of the rise from $95 million to $390 million, i.e. $295 million.

To this amount, let us add a portion of the expected first-year increase of $95 million. Let us estimate the portion assumed by small corporations at 50%, or $47 million. This gives $(295 plus 47) or 342 million, to which must be added the expected proceeds from the collection of tax on dividends received by closely-held corporations from widely-held corporations, on the assumption that most closely-held corporations are small, which comes to $60 million according to Table 16. A further $100 million is expected in taxes paid by corporations on their capital gains, and we shall estimate the share borne by closely-held corporations at 50% or $50 million.

These three categories of additional tax revenues paid directly by small corporations will add up to $452 million, out of a total increase of $560 million; we feel bound to pause here to stress that it is reasonable to believe that small corporations will bear 80% of the weight of the expected increase in corporation tax revenues.

Is this increase, falling as it does almost entirely on small corporations, counterbalanced by any reduction in taxes for their shareholders? Table 15 - "Revenue Effects of Personal Income Tax Changes ... " sheds some light on this aspect. On the basis of the $70 million increase expected at the end of the fifth year of implementation, $1,255 million is predicted as the result of rate schedule changes. Bearing in mind the proposal to raise basic exemptions and set the maximum marginal rate at 50% - a very fair proposal, incidentally - we may expect to find, among the ranks of those supporting the weight resulting from these tax reductions for some classes of taxpayers, our shareholders, who will already be burdened by the additional tax load on small corporations.

We have estimated that a corporation that pays its principal shareholder a salary of $15,000 and then has taxable income of $35,000 would, in conjunction with that shareholder, pay total taxes of $11,851 at today's rates. At the rates proposed in the White Paper, their joint tax bill would be $21,624, meaning an increase of $10,000 or almost 100%; this percentage would fall as the corporation's income rose.

The White Paper states that "The most significant factor in the longer term would be the moderate reduction in the rate of corporate saving by closely-held corporations." What effect will this "moderate reduction" have on such corporations? It has been noted that taxation will deprive them of $452 million annually in potential reinvestment. But their main source of financing is reinvested profits, drying up this source will make them unable to finance themselves, for the following reasons:

1. Any attempt to raise share capital by public subscription is difficult and expensive because of the excessively high rate of risk; the future of small corporations is often closely linked to the lifespan of its founder, and its earnings record often has no history of past profits to show.

2. Debt financing, other than for short-term needs is possible only when it is supported by an ample cushion of working capital.

It is a vicious circle. Since the corporation cannot grow by reinvesting profits, it must do so by borrowing, but borrowing is unfortunately not possible without the backing of reinvested profits.

The government may reply that it has set up such agencies as the Industrial Development Bank to serve small businesses, I would answer that in my experience, the IDB rarely advances share capital; it almost always provides debt financing and it is required that share capital invested be greater than the amount of any loan it makes. Among the criticism of the IDB

submitted to the Porter Commission by the Investment Dealers' Association was their feeling that equity requirements were perhaps excessively high in relation to the loan requested, and small businesses were bound to take on fixed obligations since, unlike big corporations that could raise capital by issuing shares, they had to make provision for annual amotization payments on debt capital and other borrowings. If we assume that a lender requires $1 in equity for every $1 in debt, every reduction in reinvestment means a reduction in total financing; from this we may conclude that if the tax proposals are implemented and an additional $450 million annually is syphoned off from small corporations in taxes, still another $450 million will be taken away in potential debt financing. Thus, almost a billion dollars annually may be taken out of the financial resources available to small corporations.

The IDB, the Quebec Provincial Industrial Credit Office, RoyNat and other lending institutions are suppliers of debt capital; loans granted by the IDB through September 30, 1969, totalled $416 million. Let us compare that figure with the total of almost a billion dollars that the tax proposals will apparently take away from small businesses, either directly or indirectly. These agencies do not substitute debt capital for risk capital, they merely correct market imperfections. In other words, their traditional practice is to step in in cases where the amount involved is not large enough to justify an issue of shares to the public. The Investment Dealers' Association went on to tell the Porter Commission that large investment houses with well-established distribution patterns could not take on the sale of small issues, that $200,000 seemed to be the smallest issue that could be handled efficiently, and that administrative costs became prohibitive on issues smaller than that. One may readily imagine how, given present money-supply conditions public financing is becoming more and more prohibitively expensive for small corporations.

I fear that small corporations will find it difficult to survive under a tax system that deprives them, every year, of potential reinvestment funds totalling some $450 million and a consequent further amount of at least $450 million in long-term borrowings.

<u>I believe it is time to ask ourselves whether the existence of small corporations is justified in our free enterprise system.</u>

It is generally recognized that true innovation, reflecting the spontaneously-felt needs of the community, is much more likely to come from small businesses than from large ones. A big company creates a product, and then stimulates a need and shapes that need to meet its own requirements. The small company senses a need and then attempts to satisfy it, and it is through such companies that a people have the best opportunity to demonstrate originality and individuality; surely the classic exemple in Quebec's case is the snowmobile industry?

Surely, too, the small corporation is more likely than any other to provide effective price competition for big corporations; small corporations start off by offering the lowest prices, made possible by their low initial overhead.

In their report on "The Effects of Federal Taxes on Growing Enterprises", Messrs. K. Butters and J. Lintner state that the constant creation and steady growth of small independent business is generally acknowledged to be an essential factor in the maintenance of a sound and competitive industrial structure.

For these reasons - innovation and competition - a true free enterprise system can exist only if conditions favour the creation and growth of new enterprises. Furthermore, the Cater Report, on which the White Paper is based, said roughly the same thing:

> "The easy entry of new firms can increase competition and hence bring about a more efficient allocation of resources. Moreover, new firms are frequently the vehicle by which new techniques and new products are introduced into the economy. In fact, an economy that actively encourages new enterprises will probably be one in which established large firms are active innovators as they seek to forestall the growth of competitors."

Let us add that encouraging the creation and growth of small businesses is a good way of combatting foreign control of our economy.

When the government helps a small business, by means of a favourable tax system or any other method, it is helping a genuinely Canadian business. This is far less certain in the case of large companies. In other words, the establishment of a strong system of small businesses, which will grow if they are helped, may be a partial solution to the problem of the control of our economy, and to that of truly Canadian research and development.

It should not be thought that we do not recognize the value of big business. But is not the large American-style corporation often the product of the continuing creation of small businesses, some of whom survive the process of natural selection and thus, by dint of their own growth and mergers with their fellow, acquire the stature of national and international corporations?

Do you not believe that reducing the chances for the creations of small businesses has the immediate result of arresting the development of large ones?

Some economists appear to connect full employment in a free enterprise economy with the existence of small corporations. In the report we cited above, Butters and Lintner stated that a high level of employment and national income could be attained in a free enterprise economy only if new businesses were constantly being created, and those that already existed were growing rapidly. This statement should be compared with statistics on the employment situation in Canadian manufacturing industries: in 1964, 45.9% of existing jobs had been created by companies employing fewer than 200.

Pausing for a moment to consider the position of taxpayers in Quebec, we might wonder if we will not be affected more than others by the reduced odds for the survival of small businesses. It seems that for a variety of reasons, both good ones and bad, we have always been less than eager to work for big companies. Will this come about despite our reluctance and

if it does, what chance shall we than have for success?

It is generally recognised, however, that small businesses deserve special treatment.

Noting the effect that the White Paper recommendations respecting the removal of the reduced rate could have on the creations and growth of small businesses, we may wonder what reasons lay behind previous policies.

We might consider passages from various budget speeches on the subject. On March 22, 1949, the Honourable D.C. Abbott spoke as follows in support of a government proposal to tax the first $10,000 or corporate profits at a reduced rate:

> "The House will at once recognize this as tax relief for small businesses and will, I trust, be heartily in accord with the policy. Our country as a whole owes a great deal to the family type of business. They have to struggle along, grow and develop in competition with large and well financed corporations .... "

On February 19, 1953, Mr. Abbott recommended extending the reduced rate to cover the first $20,000 of profits, a move he regarded as a practical way of lightening the burden for those relatively weaker companies that were compelled, generally speaking, to finance their operations out of their own revenues.

On December 6, 1967, the Honourable D. Fleming announced a further extension to cover the first $25,000, saying that he felt this would act as an incentive to small companies, and stimulate business.

On April 9, 1959, Mr. Fleming made a budget speech proposing an extension of the lower rate to take effect on January 1, 1961, and to cover the first $35,000 of profits; he felt this would have a considerable effect, particularly on those companies that were too small to have ready access to the stock market, and would thenceforth be able to broaden the scope of their activities and create more jobs, since their immediate need for reach cash to pay taxes would be reduced.

In its report, the Carter Commission devoted over one hundred pages to the problems of small businesses, and although it recommended the abolition of the reduced rate, it also suggested substantial compensations.

None of this appears in the White Paper. The Carter Report states:

> " ... we believe it would be unwise to recommend withdrawal of the low corporate rate without making some adjustment within the tax system designed specifically to assist new and small businesses."

In short, it appears that previous governments, economists and the Carter Commission recognized the need, in a free enterprise system, to assist the growth of small businesses; nevertheless, not only is there no proposal to reduce their tax burden, but it can even be expected that acceptance of the White Paper recommendations will mean a substantially increased burden both for them and for their shareholders.

What are we to expect from implementation of tax proposals? By drying up the sources of reinvestment capital and, as we have attempted to show, those of debt capital, will they not result sooner or later in the disappearance of small businesses, leaving only the big corporations?

Let us remember that the White Paper is extremely careful - and rightly so - not to increase taxes on large corporations.

Aside from the financing difficulties faced by small corporations, if taxpayers with incomes of up to $30,000 have to pay more tax, they will be unable to save and invest the proceeds in a small business.

We may well wonder, then, whether these proposals will not bring about a system under which free enterprise will exist only for the large corporations that are already all-too-largely controlled by foreign capital. We do not believe that this is a desirable system, nor do we believe that many Canadians desire it.

To conclude on a more optimistic note, let us recall that in a speech he made in Ottawa on December 17, 1969, the

Honourable E.J. Benson admitted that the White Paper was presenting problems, one of them being the proposals respecting the taxing of small corporations, and said that he thought the government would find a method of taxation that would be fair to them. We certainly hope Mr. Benson will give this matter serious consideration when the time comes to draw up the final texts of amendments to our present tax laws.

CONCLUSION

In concluding our brief, we wish to stress that our experience of small companies suggests to us that their creation and growth are closely linked to the benefit of the lower rate of corporation tax on the first $35,000 of annual profits. We believe it could prove harmful to our economy to remove the tax advantages that corporations enjoy solely in order to correct some abuses that may exist.

We also feel it would be beneficial to integrate present relationships between corproations and shareholders. Should we not accordingly support the previously advanced suggestion that dividends be treated ultimately as a form of capital repayment? In this way, dividends would become a deductable expense for the corporation, as well as being taxable income for the shareholder.

We hope that the few remarks made here will be of use to you, and we thank you for your attention.

Noiseux, Lyonnais, Gascon, Bedard,
Lussier, Senecal & Associes,
Chartered Accountants.

Montreal, February 20, 1970.

APPENDIX "D"

NAME: Noiseux, Lyonnais, Gascon, Bédard, Lussier Sénécal & Associés.

SUBJECT: Small Businesses

Analysis of Appendix "C" by Senior Advisor

This Brief is submitted by a firm of chartered accountants located in Montreal and established in 1945.

The clients of the firm are mainly small privately owned corporations that have been associated with the firm since their incorporation.

The Brief is confined to remarks upon the proposed abolition of the reduced rate of corporation tax on the first $35,000. of taxable income.

The attention of the Committee is drawn to the following comments made in the Brief.

(1) "It is reasonable to believe that small corporations will bear 80% of the burden of the anticipated increase in tax on corporation income.
The increase is not compensated for by any reduction in the taxes paid by shareholders.
(Page 1 of the Summary of the Brief).

(2) Withdrawal by the tax authorities of $452 million annually in reinvestment in the form of profits or in the equity business.
(Page 2 of the Summary of the Brief).

(3) The possibility of an equivalent withdrawal of $452 million annually in investment in the form of long term loans.
(Page 2 of the Summary of the Brief).

(4) Small businesses cannot seek capital on the open market. $200,000 would seem to be the smallest issue that can be handled efficiently; the costs of administering anything less are prohibitive.

(Page 2 of the Summary of the Brief).

(5) The probable disappearance of the small business, controlled by Canadians, in favour of the large and generally foreign owned corporation.

(Page 2 of the Summary of the Brief).

(6) The White Paper states that "The most significant factor in the longer term would be the moderate reduction in the rate of corporate saving by closely-held corporations." What effect will this "moderate reduction" have on such corporations? It has been noted that taxation will deprive them of $452 million annually in potential reinvestment. But their main source of financing is reinvested profits. drying up this source will make them unable to finance themselves.

(Page 3 of the Brief).

(7) It is a vicious circle. Since the corporation cannot grow by reinvesting profits, it must do so by borrowing, but borrowing is unfortunately not possible without the backing of reinvested profits.

(Page 3 of the Brief).

(8) I fear that small corporations will find it difficult to survive under a tax system that deprives them, every year, of potential reinvestment funds

totalling some $450 million and a consequent further amount of at least $450 million in long-term borrowings.

(Page 5 of the Brief).

(9) We may well wonder, then, whether these proposals will not bring about a system under which free enterprise will exist only for the large corporations that are already all-too-largely controlled by foreign capital. We do not believe that this is a desirable system, nor do we believe that many Canadians desire it."

(Page 9 of the Brief).

The Brief concludes with the following observations:

(1) We wish to stress that our experience of small companies suggests to us that their creation and growth are closely linked to the benefit of the lower rate of corporation tax on the first $35.000. of annual profits.

(2) We believe it could prove harmful to our economy to remove the tax advantages that corporations enjoy solely in order to correct some abuses that may exist.

(3) We also feel it would be beneficial to intergrate present relationships between corporations and shareholders.

(4) Should we not accordingly support the previously advanced suggestion that dividends be treated ultimately as a form of capital repayment? In this way, dividends would become a deductable expense for the corporation, as well as being taxable income for the shareholder.

(Page 10 of the Brief.)

On pages 1 and 2 of the Brief certain conclusions are drawn from table 16 of the White Paper.

These are:

(1) As the large corporation will lose the benefit of the low rate of tax in year 1, the full increase occuring thereafter must fall upon small businesses. They will accordingly bear at least $295 million of the increase.

(2) Some portion of the first years increase will also be paid by small corporations.

(3) Small corporations will bear 80% of the weight of the expected increase in corporation tax revenue.

There is no summary attached as no specific comments are offered respecting the White Paper proposals.

APPENDIX "E"

A SUBMISSION
(revised)

to

SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE
(Chairman, Hon. Salter Hayden)

REGARDING THE WHITE PAPER ON TAX REFORM 1969

from

Edmund H. Peachey

on behalf of

Edmund Peachey Limited)
Peachey Homes (Peel) Limited)
Valhalla Inn Limited) Islington, Ontario
Bloor Lea Investments Limited)

1. General

This submission will be restricted to the expected effects from the White Paper on Tax Reform 1969, on the affairs of the four listed above companies. They represent en toto a medium size business. They are separated, rather than consolidated, to protect their particular assets and at the same time to concentrate the management of their different activities. The first two are construction companies. Valhalla Inn Limited owns and operates a hostelry on Hwy #27 and Bloor Lea Investments owns and operates multiple housing on leased land. There is no advantage taxwise by the separation, since being associated companies, the $35,000 profit subject to 21% corporate tax is allocated to one or more companies by Form T2013. This is as required by the present Income Tax Act and we do not understand the implication that division by companies forms a "tax loophole".

2. Impairment of Economic Growth

The W/P pgh 1.10 states "The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity".

The application of this test to the reforms listed in the W/P for closely held companies shows the following deficiencies:

(a) The philosophy stated in pgh 1.40 that our private corporations compete, essentially, with smaller incorporated businesses is not relevant. For example, in the home-building area we cannot compete with the small unincorporated builder who builds custom homes and undertakes renovations. We have an organizational overhead cost which the unincorporated individual does not admit. Our competition is with the large, often widely-held, corporation. These have taken large tracts of land off the market, are often affiliated with trust companies and erect apartment suites by the hundreds. Similarly, Valhalla Inn does not compete with the "Ma-Pa" operated motels, but with the well-financed and ever-expanding American chains.

(b) The "partnership option", pgh 22-23 recognized the need for closely-held companies to retain tax-paid working capital, but its effectiveness is reduced by the following limitations:

1. All shareholders must consent to adopting the option. If one shareholder withdraws consent the plan is nullified.

2. If for any reason a shareholder is obliged to leave the country, even temporarily, the plan is nullified.

3. If a Company carries a Class B class of common stock, non-voting but participating, which is awarded to key supervisory personnel the plan is nullified.

Unless these restrictions are liberalized, most closely-held companies who are obliged to retain earnings, will not have any alternative but to adopt the "credit for tax" plan and pay out stock dividends, to be retained in the company.

(c) Provision is made under "Starting the System" for a payment of a flat rate of 15% on tax-paid earned surplus accumulated in the closely-held company. Whereas this is an improvement over the requirements of the existing Income Tax Act, it would require substantial dissipation of the company's working capital. It leads to a reduction of activity and growth and reduces the annual taxes to the governing authorities.

Suggestion

The availability of a means of retaining in the company tax-paid "undistributed income on hand" is more vital to closely-held companies than the lower rate of corporation tax on the first $35,000. of taxable income. The "undistributed income on hand" represents the working capital of the company for the rising costs of equipment, land, goods, taxes, etc. and most important of all, growth and reserve against reverses. If the government wishes to encourage a healthy rising Canadian economy, it should recognize the need for growth by working capital in tangible forms. In return for the acceptance of the single rate of 51.2% and for some equitable form of Capital Gains Tax we urge:

1. At the "Start of the System" permit tax-paid earned surplus which has accumulated to be considered a return of capital to shareholders. This is the method being followed in the proposed introduction of capital gains wherein retrogressive gains are forgiven.

2. Replace the involved techniques of "credit for tax", stock dividends, 2½ year limit, etc., with a system which allows closely-held companies to set up tax-paid undistributed income, as recommended by the Carter Commission.

This would then conform with the "practical goal" annunciated in pgh 1.14 for a system which "taxpayers can and will comply with voluntarily" and it will ensure a steady stream of tax revenue to the government of 51.2% off the top.

3. Capital Gains

(a) Simultaneous impact of Estate and Capital Gains Tax

The application of a Capital Gains Tax of 50% stacked on top of the new onerous rates in the 1969 amendments to the Estate Tax Act, would have a catastrophic effect on private companies at the death of the principal shareholder. In order to demonstrate this, below is our Accountant's analysis of the effect on one of our companies, Edmund Peachey Limited, at present inactive in the role of a holding company, and therefore a relatively straightforward example:

Balance sheet of the company at February 28, 1970:

Land	148,600.		
Fixed assets	16,000.	liabilities	124,200.
Investment-			
Peachey Homes	150,000.		
Valhalla Inn	(260,000.		
	(40,000.		
		Cap. stock	4,000.
Other assets	44,600.	Retained earnings	531,000.
	659,200.		659,200.

Valuation at death:

Shareholders' equity		535,000.
Value of land and investment in Valhalla Inn -	2,000,000.	
Less book value	188,600.	1,811,400.
		2,346,400.
	Say	2,350,000.
Death Taxes	Say	1,170,000.

Now - assume sale of land and common shares of Valhalla Inn

Sale price	2,000,000.	
Less value at purchase date of Valuation day: - $148,600. for land and, say $270,000. for common shares of Valhalla	418,600.	
Amount subject to tax	1,581,400.	
Tax theron		790,700.

Note that the company is taxable on all land sale profits; not only those accruing after Valuation day. Thus, the total tax would be $1,960,700. on a company valued at death at $2,350,000. If all of the capital gain on the common shares accrued after valuation day the tax would be further increased by approximately $60,000.

Balance sheet of the company would appear as follows:

		liabilities	124,200.
Cash	1,209,300.	Cap. stock	4,000.
Other assets	470,600.	Retained earnings	1,551,700.
	1,679,900.		1,679,900.

When the retained earnings were paid out:

1. Creditable tax of $615,000. would be available.

2. The retained earnings on hand when the system came into effect (say $531,000.) could be distributed at a tax cost of 15%.

3. $405,700. (being $1,551,700. minus $615,000. and $531,000.) would be taxed to the shareholders. However if the company was wound up an equivalent capital loss would be realized which could be deducted thereby eliminating any additional tax.

Suppose now that the company was liquidated in order to place funds in the hands of the estate to enable it to pay the death taxes of $1,170,000. The position would be as follows:

Cash received after liquidation of remaining assets at book value and payment of liabilities	1,555,700.
Less 15% tax payable on retained earnings on hand when the system came into effect	69,300.
	1,486,400.
Death taxes payable	1,170,000.
Amount available to the estate from an asset worth in excess of $2,300,000.	316,400.

This figure may also be derived as follows:

Value of the company at death		2,346,400.
Deduct taxes:		
Death taxes	1,170,000.	
Tax in corporation on realization of assets	790,700.	
15% tax on pre-system retained earnings	69,300.	2,030,000.
Balance remaining		316,400.

The balance of $316,400. is the remaining assets in a company having initially $2,350,000. which is a take-over by the government of 85%. However, it would appear from para. 3.42, that the government proposes to postpone part of it to be paid later by the beneficiaries should they decide they are compelled to dispose of the remaining assets. The paragraph is not altogether clear but a refund may be available by reason of the "cost" basis of the shares being increased by part of the death duties. To illustrate this, assume the following.

1. That, at valuation day, the value of the land was $500,000. and the value of the Valhalla common shares was $270,000. The "cost" basis of the shares would then be calculated as follows:

Shareholders' equity	535,000.
Add difference between fair values of land and Valhalla common shares and book values	581,400.
"Cost" basis of shares at death	1,116,400.

2. That the shares made up 90% of the estate. According to para. 3.42 the "cost" basis of the shares would be increased by 90% of the death taxes of $1,170,000. bringing it to $2,169,400.

On liquidation of the company the position would then be as follows:

"Dividend" received prior to winding up, net of the $531,000. pre-system surplus		955,400.
Add "gross up" (Creditable tax paid by company)		615,000.
		1,570,400.
Less capital loss on winding up "Cost" basis ($2,169,400. minus $531,000.)	1,638,400.	
Received on winding up	4,000.	1,634,400.
Amount subject to tax		nil
Tax		nil
Less creditable tax		615,000.
Tax refund		615,000.

If this analysis is correct, it may be that the Estate would be left with a balance of $931,000. i.e. with a capital of roughly 40% of the value of its former assets. This is dependent upon finding a buyer with the necessary cash and interest to pay the full market value. With the sale of the common shares of Valhalla Inn Limited, the Estate would lose control of a revenue producing asset.

Suggestion

It is obvious that no private company can survive under these conditions and so we strongly urge:

1. The Estate Tax should be withdrawn at the time of the introduction of the Capital Gains Tax.

2. Our rates of tax on long term Capital Gains should not exceed the American rate of 25%.

(b) Impact of capital gains on the Home Building Market

The production of single family homes is declining, due to the high cost of land, money and material. The single family home has been the backbone of Canadian life and economy, since Confederation, but is now being displaced by apartment and townhouse rental living. The owner of a single family home should not be further disadvantaged by a tax which would discriminate against him should he decide to sell. The $1,000. exemption would not in some cases be sufficient to avoid some tax. The exemption of $500. on personal belongings is quite inadequate in view of the declining value of the dollar and should be at least $5,000. If the regulations 3.19-27 are enforced, it will indeed make Canada a nation of bookeepers as the W/P fears (pgh 3.23). Surely the revenue from personal resources, heirlooms, collections, etc. would not warrant the cost of sifting through the reams of paper to arrive at the exact amound of tax required. If the Department of National Revenue gets into the living and bedrooms of the nation, there will be nothing but aggravation and bad feeling - and little net revenue.

Suggestion

The principal residence and all their personal assets should be placed in the "windfall" category and totally exempt from any capital gains tax.

4. <u>Entertainment and Related Expenses (pgh 5.9)</u>

The intent is not entirely clear. During field audits by the Department of National Revenue, under the present Act, we have been obliged to substantiate questionable expenses. The test applied has been whether or not, having in mind the type of business, the said expense contributes to additional revenue. Luncheons and dinners are especially needed in sales and executive circles to establish a good personal relationship leading to continued business. The facilities at Valhalla Inn are set up with this in view and it would be a loss to us and business in general if this type of expense was not deductible. Furthermore, most companies agree that there are profitable advantages in sending an employee away for an annual convention. They make contact with others in the trade and should bring back ideas to further the company's progress. There is also profit benefit when employees belong to certain business and service clubs. This can be proven and if discontinued would have an adverse effect on sales.

<u>Suggestion</u>

Let "entertainment" expense be substantiated in the form of sales and executive value. It would seem reasonable to eliminate tickets for sports events, membership in golf or other sporting clubs, etc. as a deductible expense, but Board of Trade, service clubs, etc. are a legitimate expense. Also, we submit that one convention per year, per employee should be permitted for both management and business advantage, and will benefit the taxing authority in the hotel business.

5. <u>Complexity</u>

According to pgh 1.14 "another practical goal is to design our tax system so that taxpayers can and will comply with it". We submit that the provisions of the W/P are so concerned with equity that it is far too complicated for the average taxpayer to understand, or at least, it is so involved that few persons have the time necessary to become familiar with all the variations. In the W/P, there are 381 paragraphs of new regulations to be stacked on top of the existing Act. Pgh 2.55 gives an idea of the complexity facing a taxpayer when it admits that the general average formula can be applied by the central tax assessment computer. Some of the regulations of the present Act are so incomprehensible that an expanding new industry has grown up of firms who will take over tax returns on a fee basis. Attached to this submission is a resume marked Appendix "A" which indicates how difficult it is for a taxpayer to even get an explanation of an assessment from the Department of National Revenue.

Suggestion

In our view "Tax Reform" should be directed to simplicity and that instead of adding this new structure on to the present Act, the latter should be completely re-written so that any taxpayer "can and will comply with it".

6. Spending Reform

In our view the need for Spending Reform is more acute than Tax Reform. Despite the enormous increase in government expenditure since 1960, there is no evidence that this has resulted in an equivalent improvement in social welfare or regional disparity. Before more tax burden is laid on to corporations and individuals the method of employing tax revenue should be placed under some basic control.

Some Suggestions

(a) The multiplicity of grants to Provincial Governments, conditional or otherwise, should be abolished immediately. Tax sources should be apportioned to each Provincial Government so that each is clearly responsible for their own expenditures.

(b) Disparity Payments to Provincial Governments should carry with them a built-in responsibility by the Province to improve their own economic performance. This would apply to such drastic measures as an economic union for the Maritimes (as recommended in many studies); assurance that industries located in backward areas will actually be made economically viable and not just subject to continuous grants, etc.

(c) The application of cost-benefit analysis, now being introduced by the Planned Program Budget System should be made universal throughout government departments. At the same time, information should be available to the public which will enable them to make a clear assessment of the government's financial performance.

(d) Since there is a five year tax revenue forecast, there should be a counter five year expenditure program with an 80% limit margin for contingency. Specific plans and realistic measurements should be drafted, leading to a clear definition of policy objective. If possible certain taxes should be keyed to certain objectives so that the public may be given a choice of pay or reject.

(c) "Zero-base Budgeting" deserves study. This method would require each government department every year to justify all its programs --not just new ones for which appropriations are sought. Manpower can be used to better advantage in the investment of tax money than shuffling papers.

The W/P (pgh 1.7) supports the "raising of large revenues" with a high moral aim. It also affirms to its own satisfaction that "the federal government is holding its own operating expenditures under control". This apparently refers to the current freeze on departmental expenditure. But, large scale program spending, the main culprit, goes on apace. The vague generality does not divulge how, having raised "the large revenues" duplication among governments , ill-conceived programs and bureaucratic waste, will be controlled. This is a vital area to be resolved before tax escalation is enacted.

All of which is respectfully submitted.

Edmund H. Peachey,
President.

340 The East Mall,
Islington, Ontario.

Revised
April 24th, 1970.

APPENDIX "F"

Brief

Submitted to

The Senate Committee on Banking and Commerce

Parliament Building

Ottawa

by

The Canadian Art Museum Directors' Organization

on the White Paper Proposals for Tax Reform

BRIEF OF THE

CANADIAN ART MUSEUM DIRECTORS' ORGANIZATION

ON THE WHITE PAPER PROPOSALS FOR TAX REFORM

APRIL 1970

BRIEF OF THE CANADIAN ART MUSEUM DIRECTORS' ORGANIZATION ON THE WHITE PAPER PROPOSALS FOR TAX REFORM

"The public good is served if cultural materials privately assembled are given to places of public use, and it is the business of law to encourage such gifts within legitimate limitations. A law that will prevent such gifts, and encourage the dispersal of collections by public sale instead of their gift to institutions where they will be available to all comers, is contrary to the public interest..."

from the testimony of Herman W. Liebert, Librarian of the Beinecke Rare Book Library at Yale University, offered before the United States Senate Committee in October 1969 to proposals in S. 2683.

The Canadian Art Museum Directors' Organization appreciates the effort of the Minister of Finance to effect revisions in the Income Tax Act and it would like to assist him in obtaining a more equitable law and one which would permit a climate favorable to the life of the arts. Our special concerns relate to artists, collectors and public institutions.

The art museums of the country hope their initial request to the Minister of Finance for equal treatment for all art museums qualifying under section 62(1)(e) of the Income Tax Act will receive further study. We feel obligated to point out that a number of provisions in the White Paper discourage the support of art museums and art galleries and the retention of cultural patrimony within the country. We of CAMDO fear that the nature and value of the art museum and art gallery to our society may not be appreciated by the government before it is too late. Our comments are therefore concerned with the policy of the White Paper insofar as it is urgent to our growth and survival.

Much of the health of all museums rests and will continue to rest on donations of property, of securities, of cash, of art, of antiques, and objects of virtu. Sec. 2.19 of the White Paper states that it is proposed to continue existing deductions and arrangements for charitable donations, but it should be noted that the total received by all museums is slightly less than one percent of the philanthropic dollar.

The present law in respect to all forms of donation imposes a 10 to 1 handicap on those who would donate to privately or municipally incorporated institutions serving the public interest

such as The Vancouver Art Gallery or The Montreal Museum of Fine Arts as opposed to those who would donate to federal or provincial institutions. We therefore ask the removal of the present limitation of 10% on gifts to private and municipal institutions so to allow the same 100% deductibility for gifts as is given to federal and provincial institutions. Three city galleries now raising funds for building would be immeasurably helped by such a change (Willistead Art Gallery of Windsor, Art Gallery of Hamilton and Winnipeg Art Gallery). And an increasing number of museums rely in part or in whole upon donations from individuals and corporations for their annual operations.

If we may turn to the subject of collectors and their vital relationship to museums and galleries, we would like to counter the impression that has been given that the sole concern for collecting art stems from a desire to make money. As museum men we have always found our greatest support from collectors, individuals and corporate, and should the income tax law be now amended as suggested herein, it could result in an augmentation of our artistic patrimony in the public domain. If the present arrangements continue in effect we can only expect that the growth of the collections of Canadian institutions will fall increasingly behind those of foreign cities.

In this matter of the comparative quality of world's museums, our competition gives no quarter, and liberal conditions related to gifts to art museums and galleries were, for instance, embodied in the recent reform of the income tax law in the United States. The net result, if the White Paper is carried out, will be institutions incapable of offering their public the resources which they might justly expect.

In the context of this competition and its goals we should like to propose an incentive to giving which could be combined with the proposed capital gains tax. It is suggested that donations be allowed at cost price or fair market value whichever is greater at the time of gifts. A donor should not be deemed to have obtained a capital gain on gifts of property, securities and tangible personal property appropriate to the exempt function of the donee (eg. gifts of art would be restricted to the type of institution that would use the gift in its work). This fact would provide an incentive which would create options favorable to the retention and educational application of our patrimony.

To paraphrase a colleague, "the ability of our art museums, art galleries and libraries, to continue increasing their resources for the use of all students and scholars and for the education's enjoyment of the public is far too important to be endangered by a few persons who abuse the role of donor".

We should like to affirm that museum staffs, dealers and artists would be both willing and able to support a valuation procedure where connected with donations which could at the least serve as a check to instances of suspected abuse or as confirmation to the propriety of a legitimate claim. This might take the form of a joint advisory review board as we are most concerned that a proper code of conduct should prevail.

We find the degree of bookkeeping proposed for collectors staggering (Sec. 3.23) and the idea of imposing a minimum valuation of $500.00 fraught with administrative complications both for the individual and government since one of the categories of art within this ceiling is the domain of graphics (prints and drawings). Similar problems would be presented for those whose interests encompassed material of historical interest such as maps, books and coins and stamps.

We would also point out that substantial prejudice would be caused to the collector when the value of his objets d'art has diminished substantially from their cost at valuation day. The collector might well be paying a substantial capital gain on an increased value after valuation day which in fact is only a realization of a part of his initial cost. The premise that art incurs the same kind of capital increase as a security or a savings account with compounded interest, does not take into consideration changes of taste, re-evaluation of artistic quality and determination of condition which may effect the market value of objets d'art, upwards and downwards.

With respect to objets d'art, we would suggest an election so be granted to the taxpayer that he should have the right to elect to be taxed on that portion of the capital gain that the length of time the taxpayer owns the objet d'art after valuation day bears to his entire period of ownership.

We find the restrictions of tax-deductibility of possible losses in the sale of objets d'art could cause substantial prejudice. Section 3.26 introduces the principle of treating

capital losses in relation to tangible property which permits losses to be computed only against realized gains in the same category. It would oblige the collector to sell items of appreciated value within a very short period to offset capital losses incurred by sales of art antiques and objects of virtu wherein the cost price was not reached. We would therefore suggest that the private collector should be treated in this type of asset in the same fashion as a dealer Sec. 3.27, which would avoid the spectacle of the collector trying to justify the fact that he was a dealer, a question of determination by degrees. This question of degree has occasioned substantial difference of opinion and apparently contradictory judicial decisions on the question of capital gains on real estate transactions in recent years where the Department of Revenue attempts to characterize the investor as a trader and the trader attempts to characterize himself as an investor.

We do not concur with the notion expressed in Sec. 3.26 of no decrease in value through use of painting, sculptures, jewelry and coin and stamp collections.

It seems unfair to expect a collector upon emigrating or reemigrating to another country to meet an economic iron curtain which would impose a capital gains tax both upon his intangible and his tangible property Sec. 3.40; it would indeed have unfortunate effects if the United States also were to accept this point on a reciprocal basis as a part of the tax convention between the two countries. Its immediate effect would be to inhibit the collection of art, antiques and objects of virtu, and further limit patronage to artists.

In connection with special rules Sec. 3.41 applying to gifts, in the spirit of the exemption recently enacted by the Federal Government with regard to bequests to the spouse of the deceased, we would suggest that where the donor makes bequests of art to institutions with the children of the donor having the right to retain their use during their lifetime, that this practise be allowed without being made subject to estate taxes.

The problem of passing of possession Sec. 3.42 to a private party seems properly considered. We ask whether conditions should not be included to exempt family heirlooms and family portraits from estate taxes, and to retain the capital gains tax should they be subject to sale at amounts in excess of $1,000.

The Canadian Art Museum Directors' Organization request an invitation to appear before the Committee to present their views which are also supported by the Canadian Museum Association.

Respectfully submitted,

David G. Carter
President
Canadian Art Museum Directors's
Organization

April 24th, 1970

APPENDIX "G"

C O P Y

B R I E F O F

T H E M O N T R E A L M U S E U M O F F I N E A R T S

ON THE WHITE PAPER PROPOSALS FOR TAX REFORM

MARCH 1970

Senate Committee on Banking and Commerce,
Parliament Buildings,
Ottawa.

BRIEF OF THE MONTREAL MUSEUM OF FINE ARTS
ON THE WHITE PAPER PROPOSALS FOR TAX REFORM

INTRODUCTION

The concern of the Montreal Museum of Fine Arts is the failure of the White Paper Proposals for Tax Reform to correct certain inequities in the treatment of museums under existing legislation.

We also wish to draw the Committee's attention to certain proposals relating to capital gains which discriminate against the collection of works of art.

It is not our purpose to deal in any way with the general policy expressed in the White Paper as we do not consider this to be our special field.

The Montreal Museum of Fine Arts is the oldest institution in its field in Canada, having been created

by special statute of the Parliament of the Province of Canada in 1860 on private initiative so that Montreal might have an art museum open to the public. Its collection is the most important one in the Province of Quebec and ranks with the two other most important art collections in this country. It fulfils an important cultural and educational function, yet it is unable for financial reasons to meet the public demand for its services which is rapidly increasing with the rising level of education. While it receives support from the three levels of government, it must rely principally on private generosity, because direct Government support is limited. The Museum can only hope to raise the funds it requires if Government encourages private generosity by granting a more favourable tax treatment of gifts to museums than at present exists. Such a policy would produce great benefits in terms of funds for the Museum and the preservation of works of art at what we believe to be a nominal cost to Government.

Montreal has been one of the major centres for private art collections in North America. Some of these

works have been given to our Museum, others still remain in private hands but many others have been lost to our country - irretrievably as their market value today renders their re-purchase prohibitive. Soon such collections will be a thing of the past. Canada in this field is in direct competition with the United States and unless there be some incentive to give them to museums in this country rather than to sell them, we are convinced that many of these works of great masters will be lost to future generations of Canadians.

REFORMS REQUIRED

A. The Government has recently recognized the problem to some extent under present legislation by allowing 100% deductibility for gifts to Her Majesty in Right of Canada or in Right of a province (See 27 (1) (b)). These gifts are not subject to a ceiling of 10% of net income. This provision is applicable to the National Gallery and Provincial Museums but does not extend to major institutions such as our Museum which answer a similar public need. This legislation places the latter in an inferior

position. It is discriminatory and damaging to the retention in Canada of our national treasures. It is urgent that the situation be corrected and we believe that this could appropriately be achieved by making gifts to museums which qualify as charitable organizations fully deductible from net income.

B. The White Paper provides in Section 3.41 that, where property is given, the donor is deemed to have sold the asset at its fair market value and to have made a gift of the proceeds of the sale. This proposed rule provides no incentive to encourage the gift of works of art to Canadian museums and puts Canadian museums at a very serious disadvantage as compared with their counterparts in the United States. We suggest with reference to gifts of works of art to recognized museums that the difference between the value of the work of art on the date of gift and its cost not be taxable.

C. With respect to losses incurred on works of art, Section 3.26 allows them to be deducted only from gains obtained on the same type of property in the current year, the year preceding or the year following. Since gains

realized on works of art are taxable in the same manner as gains on other property, works of art should be treated in the same manner as other property with respect to losses and a loss incurred upon disposal of a work of art should be deductible from capital gains on any property and should be carried back and carried forward the same as any other losses. Any other approach discriminates against works of art which unlike most property constitute an asset of permanent value not only for their owner but for our country as a whole as part of the national heritage.

Respectfully submitted,

MONTREAL, March 18, 1970.

THE MONTREAL MUSEUM OF FINE ARTS

Per:

President

THE MONTREAL MUSEUM OF FINE ARTS

White Paper Proposal

- Capital gain taxed on deemed realization (via gift).
- Full fair market value deductible from income.
- Deduction for charitable gift limited to 10% of income.

Recommendation of The Montreal Museum of Fine Arts

- Capital gain not taxed on deemed realization (via gift).
- Fair market value deductible from income.
- Deduction for charitable gift not limited (i.e., 100% deductible).

Assumption

- Taxpayer with salary and other income of $50,000.
- Painting with a cost basis of $10,000 and a fair market value at time of gift of $30,000.

	White Paper Proposal	Museum Recommendation	Present M.M.F.A.	Present Nat'l Gal
Year 1				
Salary and other income	$50,000	$50,000	$50,000	$50,000
Capital gain	20,000	-	-	-
Income	70,000	50,000	50,000	50,000
Charitable donation	(7,000)	(30,000)	(5,000)	(30,000
Taxable income (ignoring exemptions)	$63,000 *	$20,000	$45,000	$20,000
Year 2				
Salary and other income	$50,000	$50,000	$50,000	$50,000
Charitable donation	(5,000)	-	(5,000)	-
	$45,000 **	$50,000	$45,000	$50,000

Notes

* Under the White Paper proposals, by donating a painting, the taxpayer pays tax on $63,000 rather than $50,000.

** If carryover for donations is not extended, taxpayer pays tax on $20,000 capital gain, and may deduct only $12,000 ($7,000 + $5,000) as charitable donations.

APPENDIX "H"

NAME: THE MONTREAL MUSEUM OF FINE ARTS

SUBJECT: Gifts of Works of Art made to a Museum

Analysis of Appendix "G" by Senior Advisor

The brief has been filed by the Montreal Museum of Fine Arts.

The Montreal Museum of Fine Arts is the oldest institution in its field in Canada, having been created by special statute of the Parliament of the Province of Canada in 1860 on private initiative so that Montreal might have an art museum open to the public. Its collection is the most important one in the Province of Quebec and ranks with the two other most important art collections in this country. It fulfills an important cultural and educational function, yet it is unable for financial reasons to meet the public demand for its services which is rapidly increasing with the rising level of education. While it receives support from the three levels of government, it must rely principally on private generosity, because direct Government support is limited.

The brief itself divides itself into:

(1) A statement of why the brief is filed. This portion states:

"The Museum can only hope to raise the funds it requires if Government encourages private generosity by granting a more favourable tax treatment of gifts to museums than at present exists. Such a policy would produce great benefits in terms of funds for the Museum and the preservation of works of art at what we believe to be a nominal cost to Government.

Montreal has been one of the major centres for private art collections in North America. Some of these works have been given to our Museum, others still remain in private hands but many others have been lost to our country - irretrievably as their market value today renders their re-purchase prohibative. Soon such collections will be a thing of the past. Canada in this field is in direct competition with the United States and unless there be some incentive to give them to museums in this country rather than to sell them, we are convinced that many of these works of great masters will be lost to future generations of Canadians."

(Pages 2 and 3).

(2) A specific request that the Museum be treated as a National or Provincial Museum.

(Page 3)

(3) A reference to the White Paper proposals respecting gifts of works of art.

(Page 4)

(4) A reference to the White Paper proposals respecting losses incurred on sales of works of art.

(Page 4).

There is attached the usual summary of present tax laws, the White Paper proposals and the principal points of the brief.

Name: The Montreal Museum of Fine Arts

Principal Subject: Treatment of Museums in same manner as National and Provincial Museums.

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 27-1 of the Income Tax Act. This section permits a taxpayer who has made gifts to deduct. 1) Gifts made to Canada or a province up to 100% of the income of the taxpayer. 2) Gifts made to registered Canadian charitable organizations including museums up to 10% of the income of the taxpayer.	The White Paper makes no mention of this subject.	Pages 3 and 4, paragraph A of Brief. This portion of the brief states: A. The Government has recently recognized the problem to some extent under present legislation by allowing 100% deductibility for gifts to Her Majesty in Right of Canada or in right of a province (See 27 (1) (b)). These gifts are not subject to a ceiling of 10% of net income. This provision is applicable to the National Gallery and Provincial Museums but does not extend to major institutions such as our Museum which answer a similar public need. This legislation places the latter in an inferior position. It is discriminatory and damaging to the retention in Canada of our national treasures. It is urgent that the situation be corrected and we believe that this could appropriately be achieved by making gifts to museums which qualify as charitable organizations fully deductible from net income.

Name: The Montreal Museum of Fine Arts

Principal Subject: The Capital Gains Tax
—Gifts

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not impose a tax on the gift of a painting or other works of art made to a Museum	3.41 Special rules would be required to provide equitable treatment should a person give an asset to someone. The act now contains rules that apply when depreciable property is transferred by gift. Under these rules, the person making the gift is treated as if he had sold the asset for its fair market value and then made a gift of the proceeds. The person receiving the property is treated as if he had purchased the asset for its fair market value. These same rules would apply if other kinds of property are gifted during the lifetime of the donor.	<u>Page 4, paragraph C of Brief</u> This portion of the brief states: B. The White Paper provides in Section 3.41 that, where property is given, the donor is deemed to have sold the asset at its fair market value and to have made a gift of the proceeds of the sale. This proposed rule provides no incentive to encourage the gift of works of art to Canadian museums and puts Canadian museums at a very serious disadvantage as compared with their counterparts in the United States. We suggest with reference to gifts of works of art to recognized museums that the difference between the value of the work of art on the date of gift and its cost not be taxable.

Name: The Montreal Museum of Fine Arts

Principal Subject: The Capital Gains Tax
-Deduction of hosses on Disposition of Personal Property

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act does not impose a tax on the proceeds of disposition of paintings and other works of art.	3.26 A second type of asset within the general category does not decrease in value through use. In this group one would include paintings, sculptures, jewellery and coin and stamp collections. However, in order to recognize the personal nature of these assets and of the losses resulting on their sale, the government proposes that such losses be deducted only from gains realized on the sale of the same type of asset. If the taxpayer does not have enough taxable gains of this nature in the same year to absorb the deductible loss, the balance could be offset against such gains either in the immediately preceding year or in the year immediately following.	Page 4 paragraph C of Brief This portion of the brief states: C. With respect to losses incurred on works of art, Section 3.26 allows them to be deducted only from gains obtained on the same type of property in the current year, the year preceding or the year following. Since gains realized on works of art are taxable in the same manner as gains on other property, works of art should be treated in the same manner as other property with respect to losses and a loss incurred upon disposal of a work of art should be deductible from capital gains on any property and should be carried back and carried forward the same as any other losses. Any other approach discriminates against works of art which unlike most property constitute an asset of permanent value not only for their owner but for our country as a whole as part of the national heritage.